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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., DR. RAYMOND A. TAYLOR, and ESTATE OF FRANK EWART, John Ewart, Administrator,

Petitioners,

v.

CHARLES MOENCH, in his own right and on behalf of all others similarly situated, and on behalf of the Statewide Bancorp Employee Stock Option Plan,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

1. Whether the court below erred in holding that fiduciaries of an employee stock ownership plan ("ESOP") have a duty under the Employee Retirement Income Security Act of 1974 to consider investing the ESOP's assets in investments other than securities issued by the ESOP's corporate sponsor?

PARTIES TO THE PROCEEDING

All parties to the proceedings below are parties before this Court. The named respondent is Charles Moench who represents a class consisting of all individuals who were participants or beneficiaries of the Statewide Bancorp Employee Stock Ownership Plan sponsored by Statewide Bancorp, Toms River, New Jersey from October 20, 1988 to December 17, 1993.

The petitioners are Joseph W. Robertson, Richard D. Sutton, Joseph P. Iaria, Frank J. Ewart, Jack Meyers, Leonard G. Lomell, John C. Fellows, Jr., Dr. Raymond A. Taylor, and Estate of Frank Ewart, John Ewart, Administrator.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

Joseph W. Robertson, Richard D. Sutton, Joseph P. Iaria, Frank J. Ewart, Jack Meyers, Leonard G. Lomell, John C. Fellows, Jr., Dr. Raymond A. Taylor, and the Estate of Frank Ewart, John Ewart, Administrator, respectfully request that a writ of certiorari be issued to review the

judgment of the United States Court of Appeals for the Third Circuit entered on August 10, 1995.

OPINIONS BELOW

The opinions of the United States District Court for the District of New Jersey are not reported. (App. 49a, 60a.)[1] The opinion of the United States Court of Appeals for the Third Circuit was issued on August 10, 1995 and is reported at 62 F.3d 553. (App. 1a.) The order of the United States Court of Appeals for the Third Circuit denying the petition for rehearing is unreported. (App. 77a.)

JURISDICTION

The court of appeals entered its judgment on August 10, 1995. Respondents timely sought rehearing by the Third Circuit, and that request was denied on September 12, 1995. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 404(a)(1) of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1104(a)(1), provides:

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[1] "App." refers to the Appendix to this Petition. "3d Cir. App." refers to the Appendix filed with the court of appeals.

Subject to sections 403(c) and (d), 4042, and 4044 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and --

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and Title IV.

ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2), provides:

In the case of an eligible individual account plan (as defined in section 407(d)(3) of this title), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition

> or holding of qualifying employer real property or qualifying employer securities (as defined in section 407(d)(4) and (5) of this title).

ERISA § 407(d)(6), 29 U.S.C. § 1107(d)(6), provides:

> The term 'employee stock ownership plan' means an individual account plan --
>
> > (A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified, under section 401 of title 26, and which is designed to invest primarily in qualifying employer securities, and
> >
> > (B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

ERISA § 408(e), 29 U.S.C. § 1108(e), provides:

> Sections 406 and 407 of this title shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5) of this title) or acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 407(d)(4) of this title) --
>
> > (1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 407(e)(1) of this title),

(2) if no commission is charged with respect thereto, and

(3) If --

(A) the plan is an eligible individual account plan (as defined in section 407(d)(3) of this title), or

(B) in the case of an acquisition or lease of qualifying employer real property by a plan which is not an eligible individual account plan, or of an acquisition of qualifying employer securities by such a plan, the lease or acquisition is not prohibited by section 407(a).

26 C.F.R. §54.4975-11(b) provides:

Plan designed to invest primarily in qualifying employer securities. A plan constitutes an ESOP only if the plan specifically states that it is designed to invest primarily in qualifying employer securities. Thus, a stock bonus plan or a money purchase pension plan constituting an ESOP may invest part of its assets in other than qualifying employer securities. Such plan will be treated the same as other stock bonus plans or money purchase pension plans qualified under section 401(a) with respect to those investments.

STATEMENT OF THE CASE

Statewide Bancorp ("Statewide") was organized as a bank holding company in 1982. (3d Cir. App. 329.) In January 1986, Statewide established an Employee Stock

Ownership Plan (the "Plan"). (App. 6a.) All employee contributions to the Plan were voluntary. An amount equal to 50 percent of the voluntary contribution was matched by the employer. In addition, optional employer contributions could be authorized by Statewide's Board of Directors at the end of each plan year. (App. 8a.)

As required by ERISA § 407(d)(6), 29 U.S.C. § 1107(d)(6), and 26 C.F.R. § 54.4975-11(b), the plan documents stated that the "primary investment of the Plan shall be Statewide Bancorp Common Stock." (App. 61a.) Employees were informed by letter accompanying the initial distribution of the Summary Plan Description that the "Plan will be invested solely in Statewide Bancorp stock." (3d Cir. App. 296.) Similarly, the Plan Prospectus dated July 7, 1986 stated that "[a]ll Employer contributions are currently intended to be made in the form of shares of the Company's common stock [and] cash which is in the Participants' Employee Contribution Accounts will be used to purchase shares of Common stock, if available." (3d Cir. App. 315.) The Summary Plan Description warned that "[e]ach individual Employee's account will experience gains or losses according to the performance of the investments held by the Plan" (3d Cir. App. 174), and that the "Plan . . . does not provide for a guaranteed benefit at retirement." (App. 71a.)

Petitioners are the individuals who at various times were members of the Salary and Benefits Committee ("Plan Committee" or "Committee"), which was the named fiduciary of the Plan. The Plan Committee had the responsibility "to administer the Plan" and was given discretion to

interpret the terms of the Plan and control its administration. (App. 6a-7a.) Until early 1991, the Plan Committee remitted all monthly contributions to the Plan's trustee (Statewide's subsidiary, the First National Bank of Toms River, New Jersey, or "Trustee") for the purchase of such stock. (App. 9a-10a.)

Statewide began experiencing financial difficulties in 1989. (App. 4a.) Federal regulatory authorities became involved and, for the following two years, expressed concerns to Statewide's Board of Directors over problems with Statewide's portfolio and financial condition, requiring Statewide to greatly increase its allowances for loan losses. (3d Cir. App. 89.) The price of Statewide common stock began to fall precipitously, from $18.25 in July 1989 to $6.00 by July 1990. (App. 62a.)

Throughout this time period, the Plan Committee continued to invest all Plan assets in Statewide common stock. (App. 8a.) Jack Breda, an executive of the Trustee, testified that he became concerned that perhaps the Plan contributions should be invested elsewhere and discussed this concern with Statewide's CEO. (App. 8a-9a.) The CEO took this concern to Statewide's Board of Directors who, on behalf of the Plan's sponsor, had the power to amend the Plan. The Board of Directors rejected a recommendation to permit Plan investment in vehicles other than Statewide stock because "the original intent of the plan was to invest [in] Statewide Bancorp stock and really nothing had changed to change their minds." (App. 8a, 3d Cir. App. 120-21.)

By May 1991, the price of Statewide common stock had dropped to 25 cents per share. (App. 4a.) The Trustee

decided to cease investing in Statewide common stock and placed all of the ESOP assets in money market accounts. (App. 9a-10a.) Shortly after, on May 22, 1991, federal banking authorities closed Statewide's operating bank subsidiary. On May 23, Statewide filed a voluntary petition under Chapter 11 of the bankruptcy code. (App. 6a, 3d Cir. App. 53a.)

On November 16, 1992, this action was filed in the United States District Court for the District of New Jersey against the members of the Plan Committee by respondent Charles Moench, a former employee of Statewide and a participant in the Plan. (App. 10a.) This complaint was later amended on September 20, 1993 asserting, *inter alia*, a claim for breach of fiduciary duty under ERISA § 502(a)(2), 29 U.S.C. § 1132(a)(2). Plaintiff invoked the district court's jurisdiction under ERISA § 502(e), 29 U.S.C. § 1132(e), and under 28 U.S.C. § 1331. (App. 11a-12a.)

Respondent claimed that the Committee had breached its fiduciary obligations under ERISA by investing Plan assets in Statewide stock. The district court granted defendants' motion for summary judgment on this claim, holding that the plan documents mandated that the Committee invest the ESOP assets solely in Statewide stock. (App. 11a-12a.)

The Court of Appeals for the Third Circuit reversed the grant of summary judgment, finding that -- despite the fact that the purpose of the Plan was expressly stated to be investment in Statewide stock (App. 29a-32a) -- the terms of the Plan did not "absolutely require[ ]" the fiduciary to invest in employer securities but "more than simply

permitted" it. (App. 41a.) Although stating that an ESOP fiduciary who invests the assets in employer stock "is entitled to a presumption that it acted consistently with ERISA by virtue of that decision," that presumption could be rebutted by introducing evidence that "owing to circumstances not known to the settlor and not anticipated by him," the purchase of employer securities would defeat the purpose of the trust. (App. 41a.) Despite the fact that the Board of Directors of Statewide -- the plan sponsor -- had as recently as May 1991 reconfirmed that the purpose of the Plan was to purchase and hold Statewide stock, the Third Circuit found it possible that "the precipitous decline in the price of Statewide stock, as well as the Committee's knowledge of its impending collapse . . . [may have] changed circumstances to such an extent that the Committee properly could effectuate the purposes of the trust only by deviating from the trust's direction." (App. 43a.) The court of appeals therefore reversed the district court's grant of summary judgment and remanded the case for trial to the district court. (*Id.*)

REASONS FOR GRANTING THE WRIT

In enacting legislation to authorize and promote the establishment of ESOPs, Congress expressed a national policy that employees be encouraged to share, through ESOP stock ownership, in the fortunes of their employers. Congress envisioned that ESOPs would provide necessary funds for capital growth and tie employees' interests more closely to those of employers while allowing employees to

build their personal capital for retirement and other purposes.

The decision below frustrates that Congressional intent by holding that ESOP fiduciaries may be sued under ERISA for making the very investment in employer securities that ESOPs are designed to make. If ESOP fiduciaries are subject to suit for investing in employer securities rather than in other investments, then the fundamental purpose of ESOPs will be overridden. In order to resolve this central question in the administration of ESOPs and to end the confusion and conflict among the lower courts over how ERISA's fiduciary rules should apply to investment decisions by ESOP fiduciaries, review by this Court is warranted.

I. Congress Intended to Encourage ESOPs, Not Discourage Them Through an Overreaching Application of ERISA's Fiduciary Rules

Under ERISA and related provisions of the Internal Revenue Code, the term employee stock ownership plan, or ESOP, refers to a tax-qualified plan that "specifically states that it is designed to invest primarily in qualifying employer securities," typically, the stock of the ESOP's sponsoring employer. 26 C.F.R. § 54.4975-11(b); *see also* ERISA § 407(d)(6). Congress intended that ESOPs, as vehicles for employee investment in employer stock, would serve not only to provide retirement income to employees but also as a "'technique of corporate finance' that would encourage employee ownership." *Martin v. Feilen*, 965 F.2d 660, 664 (8th Cir. 1992), *cert. denied*, 113 S. Ct. 979 (1993), *quoting*

129 Cong. Rec. S16629, S16636 (Daily ed. Nov. 7, 1983) (statement of Sen. Long).[2]

To encourage the establishment and maintenance of ESOPs, Congress has, through the years since ERISA's passage, enacted various tax incentives beyond those that apply to tax-qualified retirement plans generally. These have included various tax credits for contributions to certain types of ESOPs (*see* Tax Reduction Act of 1975 § 301(d)(6), since repealed); exemption of 50 percent of a qualified lender's interest income from loans made to finance certain ESOP acquisitions of employer stock (26 U.S.C. § 133); deferral of capital gains taxes for certain sales by shareholders of privately held corporations who sell shares to an ESOP and invest the proceeds in "qualifying replacement property" (26 U.S.C. § 1042); favorable estate tax treatment for certain stock sales to ESOPs (*see United States v. Carlton*, 114 S. Ct. 2018 (1994)); and deductibility of dividends paid on stock held by an ESOP (26 U.S.C. § 404(k)).

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[2] *See also* Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(a), 90 Stat. 1590 (1976):

> The Congress, in a series of laws . . . and this Act has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees.

At the same time as Congress sought to encourage ESOPs, it gave ESOPs and other "eligible individual account plans" specific exceptions from certain of ERISA's rules governing fiduciary duties. Thus, the definitive Conference Report on ERISA stated that:

> If securities are qualifying employer securities they generally can be acquired or held notwithstanding the prohibited transaction rules, if acquisition is for adequate consideration and no commission is charged and if acquisition is allowed by the employer securities rules. However (except as noted above for eligible individual account plans), acquisition and holding of these assets must also meet the rules of prudence, diversification, etc.

H.R. Conf. Rep. No. 93-1280 at 320, 93d Cong., 2d Sess. 297 (1973), *reprinted in* 3 Senate Subcomm. on Labor, Legislative History of ERISA 4518, 4587 (Comm. Print 1976) *and in* 1974 U.S. Code Cong. & Admin. News 5038, 5100.

To provide expressly for this special treatment of ESOPs, Congress enacted ERISA § 408(e), 29 U.S.C. § 1108(e), which excepts the acquisition and sale of qualifying employer securities under certain conditions from ERISA's prohibited transaction rules in ERISA § 406, 29 U.S.C. § 1106. It also enacted ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2), which provides that eligible individual account plans are not subject to the general fiduciary duty of ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C), to diversify plan investments and are not subject to the duty of

prudence in § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B), to the extent it requires diversification of investments.

Despite its desire to apply fiduciary standards in some measure to the administration of ESOPs, Congress remained resolute that the application of such standards not frustrate the overriding goal of employee ownership. Most notably, in enacting additional incentives to the formation of ESOPs in 1976, Congress sharply criticized federal agency actions that sought to treat ESOPs according to fiduciary standards applicable to other retirement plans. Thus, the Tax Reform Act of 1976 stated:

> The Congress is deeply concerned that the objectives sought by [a series of laws passed to encourage employee stock ownership, including ERISA] will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.

Pub. L. No. 94-455, § 803(h), 90 Stat. 1590 (1976)

II. The Lower Courts are in Confusion Over Application of ERISA's Fiduciary Rules to ESOPs

Given the varied goals of Congress in authorizing ESOPs, it is not surprising that the lower courts have diverged in their application of ERISA's fiduciary rules to

ESOPs. As the court summed up the dilemma in *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984):

> On the one hand, Congress has repeatedly expressed its intent to encourage the formation of ESOPs by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that goal. Competing with Congress' expressed policy to foster the formation of ESOPs is the policy expressed in equally forceful terms in ERISA: that of safeguarding the interests of participants in employee benefit plans by vigorously enforcing standards of fiduciary responsibility.

Id. at 1466 (citations omitted).

Donovan v. Cunningham involved one of the situations in which ERISA's fiduciary rules clearly were intended to apply to ESOPs, *i.e.*, in determining whether an ESOP paid or received a fair price in acquiring or selling employer securities. There, the Secretary of Labor challenged the decision of a fiduciary committee that administered an ESOP to purchase employer stock at inflated prices from one of the Committee members. 716 F.2d at 1458. As noted above, § 408(e) of ERISA, expressly permits such purchases provided, among other things, that the purchase is for no more than "adequate consideration." In holding that the defendant fiduciaries had violated their fiduciary duties by paying in excess of "adequate consideration" for the stock, the *Donovan v. Cunningham* court incorporated into the

definition of "adequate consideration" the test developed under the case law for determining compliance with the prudent person standard of conduct in ERISA § 404(a)(1)(B). *Id.* at 1467. Similar holdings have been reached by other courts addressing the prudence of the price at which the ESOP acquires or sells employer stock.[3]

Thus, there is general consensus among the lower courts regarding the applicability of ERISA's fiduciary rules to decisions involving the price paid or received by an ESOP for employee stock. Likewise, outside of the investment context, there is no controversy that ERISA's rules imposing fiduciary duties in plan administration -- including fiduciary duties of disclosure[4] and fiduciary duties in handling benefit claims[5] -- apply equally to ESOP administrators as they do to administrators of other ERISA plans.

Where, however, no issue is presented regarding the administration of an ESOP and no challenge is raised to the

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[3] *See Eaves v. Penn*, 587 F.2d 453, 459 (10th Cir. 1978); *Reich v. Valley Nat'l Bank of Arizona*, 837 F. Supp. 1259, 1273 (S.D.N.Y. 1993); *Martin v. Harline*, 15 Employee Benefits Cas. (BNA) 1138, 1151-52 (D. Utah 1992); *Hood v. Smith's Transfer Corp.*, 762 F. Supp. 1274, 1294 (W.D. Ky. 1991).

[4] *See, e.g., Elmore v. Cone Mills Corp.*, 23 F.3d 855 (4th Cir. 1994) (*en banc*); *Sweeney v. Kroger*, 773 F. Supp. 1266 (E.D. Mo. 1991).

[5] *See, e.g., Bachelder v. Communications Satellite Corp.*, 837 F.2d 519 (1st Cir. 1988); *McDonald v. Pan American World Airways, Inc. Employee Stock Ownership Plan*, 859 F.2d 742 (9th Cir. 1988).

price paid or received by the ESOP for its employer stock, the courts have diverged in their application of fiduciary rules to ESOP investment decisions. As the court below aptly stated, it is as to these decisions -- particularly as to decisions regarding whether to invest in employer securities -- that the conflict between the statutory goals related to ESOPs "becomes particularly stark." (App. 36a.) A number of courts have endorsed, at least in principle, the absolutist view -- consistent with the position advanced by the Secretary of Labor as *amicus curiae* in the court below -- that the general fiduciary duties of ERISA override any special treatment of ESOPs and fully apply to all ESOP investment decisions.[6]

This position has been criticized by commentators and rejected by other courts as inconsistent with the fundamental purpose of ESOPs. In *Ershick v. United Missouri Bank of Kansas City, N.A.*, 948 F.2d 660 (10th Cir. 1991), ESOP participants brought suit against an ESOP trustee who, similar to the facts of this case, had maintained the investment of all of the ESOPs assets in employer stock during a period of great price decline in that stock. The district court rejected this claim, finding that the trustee was required to invest in employer stock in order to carry out the purpose of the ESOP and stating that:

> ERISA requires trustees to carry out the aims of the plans they administer; trustees who disregard

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[6] *See, e.g., Canale v. Yegen*, 782 F. Supp. 963, 967-68 (D.N.J. 1992); *Burud v. Acme Elec. Co.*, 591 F. Supp. 238, 246-48 (D. Alaska 1984).

> the stated purpose of an employee stock ownership plan to invest primarily in employer securities and who instead invest in non-employer investments may be liable for breach of fiduciary duties.

948 F.2d at 665, *citing* 705 F. Supp. 1482 (D. Kan. 1989). On appeal, judgment in favor of the trustee was affirmed. 948 F.2d at 669.

Consistent with *Ershick*'s analysis, expert commentary on ESOPs has decried the wholesale application of ERISA's fiduciary rules to ESOPs. As an American Bar Association subcommittee report stated: "To require an investment primarily in employer stock on one hand and then to question the prudence of the investment seems contradictory." Report of the Subcommittee on Employee Stock Ownership Plans, Committee on Employee Benefits, ABA Section of Tax'n, *ESOPs Foibles*, 31 Tax Law. 561, 576 (1978). Likewise, in *Fiduciary Aspects of Employee Stock Ownership Plan Investments in Employer Securities*, 23 Real Prop. & Prob. Trust J. 575 (Winter 1988), a leading practitioner in ESOP issues concluded that application of ERISA's prudence rule to ESOP investment decisions made no sense except where -- as in the *Donovan v. Cunningham* line of cases and unlike this case -- the question presented was whether the ESOP had overpaid for its employer stock or received too low a price for its sale.

III. The Decision Below is in Error and Warrants Review by This Court

The decision below only deepens the confusion and conflict over the application of ERISA's fiduciary rules to investment decisions by ESOP fiduciaries. As in *Ershick*, the threshold issue in this case is whether petitioners, as ESOP fiduciaries, had a duty under ERISA to consider investing the ESOP's assets in something other than stock of Statewide Bancorp. The district court, relying on its analysis of ERISA and of the documents governing the ESOP at issue, held that no such duty existed and granted summary judgment to petitioners. (App. 72a.)

The Court of Appeals for the Third Circuit reversed. The court disagreed with the district court's interpretation of the governing ESOP documents, finding that they required petitioners to invest ESOP assets only "primarily," not "exclusively," in Statewide Bancorp stock. (App. 33a.) The court rejected as inconsistent with Congressional intent concerning ESOPs the view advocated by respondent and his *amici*, including the Secretary of Labor, that ERISA's fiduciary rules apply wholesale to investment decisions by ESOPs. At the same time, the court created a new test for applying those rules to ESOP investments. The court held that an ESOP fiduciary who invests the assets of the plan in employer stock "is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." (App. 41a.) However, plaintiffs may rebut that presumption by introducing evidence that "owing to circumstances not known to the settlor and not anticipated by him," the purchase of employer securities would defeat the purpose of the trust.

Id. "[I]n other words, the plaintiff must show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate." (App. 41a-42a.)

Although the court's rejection of respondent's argument below is welcome, its introduction of yet another standard for measuring the conduct of ESOP fiduciaries adds to the confusion in the case law and subjects these fiduciaries unfairly to massive personal financial liability for faithfully implementing the ESOP's obvious and central purpose. Even under this standard, petitioners believe they will ultimately prevail on the merits of this case.[7] This Court's review is, however, necessary since the decision below is wrong, and ESOP fiduciaries, including petitioners, should not be subjected to liability for investing in employer securities where no question is raised about the price paid or received by the ESOP for the securities.

In enacting the provisions that relieve ESOP fiduciaries of any duty to diversify ESOP investments and permit the holding of 100 percent of plan assets in employer securities, the Congress that enacted ERISA intended to permit ESOPs to be fully invested in such securities. Indeed, one of the key distinctions made in ERISA between ESOPs and other "eligible individual account plans" that are

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[7] In its recent decision in *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995), the Sixth Circuit adopted the standard enunciated by the court of appeals in this case and affirmed a judgment in favor of ESOP fiduciaries similarly situated to petitioners here.

permitted to invest in employer securities is that ESOPs are *required* to invest in such securities. As the very name of an ESOP suggests, the purpose of an ESOP is "employee stock ownership" of the ESOP's sponsoring employer.

Moreover, when the question of non-diversification of ESOP assets was raised in subsequent Congresses, Congress enacted a requirement for election of limited diversification of ESOP assets by certain employees aged 55 or older. *See* 26 U.S.C. § 401(a)(28). Thus, when Congress wanted to mandate that ESOP assets be invested other than in employer securities, it changed the law to do so. Consistent with its desire that ESOPs otherwise remain essentially invested in employer securities, Congress enacted, as part of the many tax incentives provided to encourage ESOPs, excise tax penalties on amounts transferred to ESOPs on various tax-favored bases that did not thereafter remain invested in employer securities. *See* 26 U.S.C. § 4978 (generally imposing an excise tax if an ESOP disposes of employer securities within three years after their acquisition under 26 U.S.C. § 1042); 26 U.S.C. § 4978A (imposing an excise tax if an ESOP disposes of employer securities within three years of an acquisition under 26 U.S.C. § 2057); 26 U.S.C. § 4980 (excepting from an excise tax on a reversion of surplus pension assets amounts transferred to an ESOP and used in connection with acquisition of employer securities, provided those securities remain in the plan until distribution to participants).

As the court noted in *Martin v. Feilen*, 965 F.2d 660, 664 (8th Cir. 1992), *cert. denied*, 113 S. Ct. 979 (1993), while policy criticisms can and have been made

about ESOPs and their non-diversification of assets, "that is a question for Congress." Where Congress has spoken and permitted ESOP assets to be non-diversified and fully invested in employer securities, the courts should not undo that Congressional intent by the back-door imposition of general fiduciary duties.

Nor can the decision below be justified by the court's finding that the ESOP at issue here required that assets be only "primarily" not "exclusively" invested in employer securities. (App. 32a.) As noted above, definitive regulations governing ESOPs expressly require that an ESOP "specifically state[ ]" that it is designed to invest "primarily" in employer securities. *See* 26 C.F.R. § 54.4975-11(b). Thus, every ESOP that intends to make its long-term investment exclusively in employer securities will contain the "primarily" language. Use of the word "primarily" preserves the ability to invest in alternative assets where, as discussed above, it is statutorily required for employees nearing retirement age, *see* 26 U.S.C. § 401(a)(28); where, as here, a portion of the assets are kept in short-term cash-equivalent investments in order to provide liquidity "for the payment of administrative expenses and cash distributions" (App. 7a); and where an ESOP forms only a portion of a plan, the balance of which contains investments that are fully subject to normal fiduciary rules, *see* 26 C.F.R. § 54.4975-11(a)(5). Use of the word "primarily" did not distinguish the Statewide ESOP from other ESOPs or suggest any intent that Plan assets be invested in other than Statewide stock, and the court below erred in so holding.

The court also erred in fashioning a rule based on trust law that the ESOP fiduciaries' conduct must be viewed in light of whether there are changed circumstances which warrant a variance from the settlor's original intent. That rule makes sense in a typical trust law situation where, for example, the settlor under a will is deceased and can no longer express a current intent. Under ERISA, however, the settlor of an employee benefit plan, *i.e.*, its corporate sponsor, retains the inherent power to modify or even terminate the plan at any time and for any reason.[8] Given that principle, there is no basis on which to subject ESOP fiduciaries to liability for either second-guessing, or failing to second-guess, the sponsor's stated intent to invest in employer securities. Rather, the sponsor itself can decide on an ongoing basis whether the ESOP continues to serve the purpose for which it was established and can act accordingly.

According to published statistics, approximately 9,500 ESOPs now exist in the United States and cover 11 million employees. *See Employee Stock Ownership Plans 1995 Yearbook* (Robert W. Smiley, Jr., *et al.*, eds., 1994) ¶ U.1. The tremendous growth in the number and scope of ESOPs has sprung directly from Congressional intent and incentives to foster ESOP investment in employer securities. By calling into question the lawfulness of ESOP investment in employer securities and threatening ESOP fiduciaries with

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[8]*See, e.g., Siskind v. Sperry Retirement Program*, 47 F.3d 498, 505 (2d Cir. 1995); *Izzarelli v. Rexene Products Co.*, 24 F.3d 1506, 1524-25 & n.33 (5th Cir. 1994); *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1161 (3d Cir. 1990) (collecting cases).

personal financial liability for choosing employer securities over other possible investments, the decision below runs counter to that Congressional intent. Accordingly, review by this Court and reversal of the decision below is appropriate.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari on the question presented.

Respectfully submitted,

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December 11, 1995

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Appendix A

Opinion of the Court of Appeals for the Third Circuit
(filed August 10, 1995)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 94-5637

CHARLES MOENCH in his own right and on behalf of those similarly situated, and on behalf of the Statewide Bancorp Employee Stock Option Plan

v.

JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., RAYMOND A. TAYLOR, ESTATE OF FRANK EWART, JOHN EWART, ADMINISTRATOR

Charles Moench, in his own right and on behalf of all those similarly situated, Appellant.

On Appeal from the United States District Court
for the District of New Jersey.
(D.C. No. 92-4829).
Argued June 26, 1995
BEFORE: MANSMANN, GREENBERG and SAROKIN
Circuit Judges

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OPINION OF THE COURT

GREENBERG, Circuit Judge:

This case requires us to decide the following difficult question: To what extent may fiduciaries of Employee Stock Ownership Plans (ESOPs) be held liable under the Employee Retirement Income Security Act (ERISA) for investing solely in employer common stock, when both Congress and the terms of the ESOP provide that the primary purpose of the plan is to invest in the employer's securities. The district court held that fiduciaries cannot be liable in such cases, and therefore it granted the fiduciaries' motion for summary judgment. Because we conclude that in limited circumstances, ESOP fiduciaries can be liable under ERISA for continuing to invest in employer stock according to the

plan's direction, we will vacate the district court's grant of summary judgment in favor of the plan fiduciaries and will remand the case to the district court for further proceedings. In this opinion we will refer to the plaintiff-appellant Charles Moench, a plan beneficiary, as "Moench," and the defendants-appellees, the Plan Committee, the fiduciaries with investment responsibilities, singularly as the "Committee."

I. Introduction

A. Statewide's Demise

Statewide Bancorp was a bank holding company with its principal office in Toms River, New Jersey. During the time relevant to this appeal, it operated through two wholly owned subsidiaries, The First National Bank of Toms River, New Jersey (FNBTR), and The First National Bank of New Jersey/Salem County. Statewide began experiencing financial difficulties in 1989. "Between July 1989 and December 1989, the market value of Statewide Bancorp common stock fell from $ 18.25 per share to $ 9.50 per share." Dist. Ct. op. at 2. During the next year, the price fell even more precipitously -- to $ 6.00 per share in July 1990, to $ 2.25 per share in December, and finally to less than 25 cents per share in May 1991. During this period -- from 1989 through 1991 -- federal regulatory authorities repeatedly expressed concern to Statewide's Board of Directors over problems with Statewide's portfolio and financial condition. On July 31, 1989, the Office of the Comptroller of the Currency (OCC) informed the Statewide Board that "compliance management in the two subsidiary banks was found to be satisfactory in virtually all areas."

Letter of July 31, 1989 at Expanded Appendix (EA) 606.[1] Nevertheless, the OCC letter indicated that "violations of law and regulation were found across a number of areas in the subsidiary banks [and] while management has shown a commitment to promptly correct all violations, the need to develop in certain cases and otherwise improve policies and procedures is clearly evident." *Id.* A March 1990 report of an off-site review of FNBTR revealed "lack of depth and quality of management, unsafe and unsound credit practices, the resulting rapid deterioration in the quality of the loan portfolio, unreliable regulatory and management reports on loans, the inadequacy of the Allowance for Loan and Lease Losses, and the adverse impact of asset quality upon

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[1] We cite the appendix as "app.," the supplemental appendix as "SA" and the expanded appendix as "EA." There is an expanded appendix because the Committee made a motion which Moench opposed to expand the appendix to include materials which were not before the district court. Ordinarily we would have denied the motion. Here, however, a significant portion of the expanded appendix consists of actual copies of documents that were summarized to the district court pursuant to Fed. R. Evid. 1006. Rule 1006 states that "the contents of voluminous writings . . . which cannot conveniently be examined in court may be presented in the form of a chart, summary, or calculation," provided that "the originals, or duplicates, shall be made available for examination [and t]he court may order that they be produced in court." For all practical purposes, then, these actual documents were before the district court, though the court did not feel a need to examine them. It seems to us that when a party relies on a Rule 1006 summary to support its position on an appeal, at least when, as here, the appellate court exercises de novo review over the district court decision, the appellate court similarly may examine the actual documents. Therefore, we will grant the Committee's motion to expand the appendix. We note, though, that we cite to the expanded appendix only to make clear the factual underpinnings of this appeal, and whenever possible, we include parallel citations to similar propositions in the appendix or the supplemental appendix.

earnings and capital adequacy." EA 690. Ultimately, on May 22, 1991, the Federal Deposit Insurance Corporation took control of FNBTR and on May 23, 1991, Statewide filed a voluntary petition under Chapter 11 of the Bankruptcy Code.

B. Statewide's ESOP Plan

This case involves not so much Statewide's demise but the fate during the period of its decline of funds invested in its ESOP. Beginning on January 1, 1986, Statewide offered its employees the opportunity to participate in the ESOP, which was designed to invest primarily in Statewide common stock. *See* Summary Plan Description at app. 174. The ESOP named various entities and gave them specific administrative and fiduciary duties. First, an ESOP Committee was set up "to administer the Plan." The Statewide Bancorp Employee Stock Ownership Plan Art. 10.1 at EA 451; app. 150 (Trust Agreement); SA 306-07 (Summary Plan Description). The plan provided that the Committee "shall adopt rules for the conduct of its business and administration of the Plan as it considers desirable, provided they do not conflict with the Plan." EA 451 (Plan, Art. 10.2); SA 307 (Summary Plan Description). The documents authorized the Committee to "construe the Plan, correct defects, supply omissions or reconcile inconsistencies to the extent necessary to effectuate the Plan, and such action shall be conclusive." EA 451 (Plan, Art. 10.4); SA 298a-299, 307 (Summary Plan Description). To allow the Committee fully and adequately to perform its duties, the plan authorized it to "contract for legal, actuarial, investment management . . . and other services to carry out the Plan." EA 451 (Plan, Art. 10.3); App. 150 (Trust Agreement); SA 307 (Summary Plan

Description). According to the Trust Agreement implementing the plan, the Committee:

> shall have responsibility and authority to control the operation and administration of the Plan in accordance with the terms of the Plan and of this Agreement, including . . . (i) establishment, in its discretion, of investment guidelines which shall be communicated to the Trustee in writing.

Trust Agreement Art. 7.2 at app. 150-51. The Trustee of the plan had "exclusive responsibility for the control and management of the assets of the Trust Fund," Trust Agreement at app. 150.

The plan provided that:

> Except as otherwise provided in this Section, the Trustee shall invest the Fund as directed by the Committee. Generally, within 30 days of receipt, the Trustee shall invest all contributions received under the terms of the plan not applied to the repayment of principal and interest on any Acquisition Loan in ESOP stock, except that the Trustee shall be authorized to invest a portion of the contributions received in other securities as a reserve for the payment of administrative expenses and cash distributions.

App. 148 (ESOP Plan, Amended and Restated Effective Jan. 1, 1989). The plan documents gave Statewide, as the plan sponsor, "the authority and responsibility for . . . the design of the Plan, including the right to amend the Plan." Trust Agreement Art. 7.3 at app. 151. The plan documents also required Statewide to exercise "all fiduciary functions

provided in the Plan or in this [Trust] Agreement or necessary to the operation of the Plan except such functions as are assigned to other fiduciaries pursuant to the Plan or this Agreement." *Id.*

The ESOP created and governed by these documents worked as follows: Employees became eligible to participate in the plan after one year of service. Employees who chose to participate had their contribution deducted from their salary; the employer then would match up to 50% of the employee's voluntary contribution. The plan also provided for an Employer Profit Sharing Contribution, to be made at the end of the Plan year, though only at the option of the Statewide Board of Directors.

Throughout the relevant time period, the Committee regularly invested the ESOP fund in Statewide common stock, despite the continual and precipitous drop in its price and despite the Committee's knowledge of Statewide's precarious condition by virtue of the members' status as directors. Yet the record reflects that several Statewide insiders began to have misgivings regarding the investment. Jack Breda, FNBTR's Director of Personnel, testified that when the price of Statewide stock started to drop, he began thinking it would be inappropriate to continue such investments. App. 119. He further testified that he relayed to Statewide's chief executive officer (CEO) the pension committee's recommendation that "we [should] look for other vehicles to invest money in," and that the CEO should relay that advice to the executive committee or the Board of Directors. App. 120. Apparently, the CEO reported back that the Board of Directors had rejected the proposal because "the original intent of the plan was to invest [in] Statewide

Bancorp stock." App. 120. On May 13, 1991, C.T. Bjorklund, Statewide's Benefits and Compensation Manager, wrote a memorandum to Breda stating the following:

> The Statewide [ESOP] permits employees to voluntarily suspend contributions at any time during the year. The Bank can also cease contributions at any time without notice. Such discontinuance would not trigger a full vesting situation. Only a complete plan termination would cause immediate full vesting of all participants.
>
> Although the ESOP gives us a beginning bias to hold Statewide Stock and the plan says that amounts contributed are to be invested in company stock, the trustee has the power to invest in other vehicles. Potentially the trustee should consider investing in short term money market instruments with current and future contributions.

App. 90. A notation from Breda to Bjorklund at the bottom of the memorandum states "I have been notified by [the CEO] on 5/21/91 that the Executive Committee of Statewide Bancorp voted not to accept the revised or restated ESOP plan . . . ." App. 90.

Kevin William Bless, Assistant Vice President and Senior Pension Trust Officer of FNBTR testified that as Statewide's stock price fell, FNBTR's Trust Division held general discussions "about the permissibility of investing moneys in ESOP in a stock that had potential problems." App. 136. The Trust Division decided that since the Committee's knowledge of Statewide's precarious state was based on confidential reports issued by the OCC, it would be

inappropriate to use the information in making investment decisions. Thus, Bless testified that "the nature of the ESOP dictated that we invest solely in [Statewide] securities absent any public knowledge that it would be an imprudent investment." App. 139. In these discussions, then, the ESOP was not seen as absolutely requiring investment in Statewide stock. Indeed, in early 1991 the Trustee decided to cease investing in Statewide stock and to place all of the ESOP assets in money market accounts.

The Committee has not directed our attention to anything in the record to suggest that while the stock price was falling and the OCC was issuing its warning letters, the Committee met to discuss any possible effects on the ESOP or any actions that it should take and we have not found any indication that there was such a meeting. Moreover, although on June 12, 1990, investors filed a class action securities fraud suit against Statewide and certain of its directors (the Lerner action), which eventually settled for $ 3,200,000.00, the Committee did not participate on behalf of the ESOP and therefore the ESOP did not share in the settlement. Ultimately, Statewide's descent rendered the employees' ESOP accounts virtually worthless.

C. The Litigation

On November 16, 1992, Moench, a former Statewide employee who participated in the ESOP plan, brought this action against the members of the Committee. These defendants were also members of Statewide's Board of Directors. However, he did not sue either the Trustee or the plan sponsor, Statewide. In his first complaint, he charged the Committee with breaching its fiduciary duties under ERISA and pleaded a securities fraud suit on behalf of the

ESOP. Moench moved to certify the class and the Committee moved to dismiss the complaint. In an August 17, 1993 opinion and order (entered four days later), the district court dismissed a count Moench advanced that the plan should have been amended or terminated because "regardless of whether terminating or modifying the Plan would have proved to be prudent conduct, such action is not that which is encompassed within a director's fiduciary duties under ERISA." Op. at SA 256 (citing *Hozier v. Midwest Fasteners, Inc.*, 908 F.2d 1155, 1161 (3d Cir. 1990)). The court denied the motion to dismiss the remaining ERISA counts but dismissed the securities fraud count without prejudice for failure to plead with the particularity required by Fed. R. Civ. P. 23.1. The court requested further briefing on Moench's class certification motion. Op. at 4-5.

Moench responded by filing an amended complaint, principally under 29 U.S.C. § 1132(a)(2), for breach of fiduciary duty under 29 U.S.C. §§ 1104 and 1109. Count 1 charged the Committee with breaching its fiduciary obligations under ERISA; Count 2 sought to hold the members of the Committee liable for breaches of their co-fiduciaries; Count 3 charged it with failing to disclose and misrepresenting pertinent information concerning Statewide's condition, that affected employees' decision to invest in the ESOP; Count 4 charged breaches of fiduciary duties on behalf of the ESOP, including failing to file a securities fraud action on behalf of the plan; and Count 5 plead on behalf of the ESOP a securities fraud claim under 15 U.S.C. § 78 *et seq.* On December 20, 1993, the district court issued an order certifying a class as to the first three counts and allowing Moench to prosecute the derivative actions on

behalf of the ESOP.

On July 18, 1994, Moench filed a motion for a partial summary judgment declaring that the individual Committee members were fiduciaries governed by the standard of care provided in ERISA. The Committee did not oppose Moench's motion, and thus it admitted that its members were ERISA fiduciaries. The Committee nevertheless filed a cross-motion for summary judgment dismissing the complaint on the ground that it did not breach its ERISA obligations. The district court issued an opinion and order on September 21, 1994, granting both motions.

Noting that the Committee had conceded its fiduciary status, the court granted Moench's motion without analysis. The court then held that the Committee had no discretion under the terms of the plan to invest the ESOP funds in anything other than Statewide common stock. And since the plan complied with ERISA, "[Moench] has failed to establish that [the Committee's] actions in directing the purchases of stock for the Plan were other than in accordance with the requirements of the Plan or otherwise in violation of ERISA." Op. at 12. The court found no merit in Moench's allegations that the Committee gave inaccurate, incomplete and false information about the plan. Rather, it observed, "the Plan specifically provides that it 'is a capital accumulation Plan [and therefore] . . . does not provide for a guaranteed benefit at retirement,'" op. at 12 (first alteration added), and that "the very nature of ESOP plans contemplates that the value and security of the employees' retirement fund will necessarily fluctuate with the fortunes of the employer because ESOPs invest primarily in employer stock." *Id.* Finally, the court held that the statute of

limitations barred Moench's derivative securities fraud suit. *Id.* at 16.

Moench timely filed this appeal. He argues that the district court erred in deciding that the plan documents absolved the Committee from any liability resulting from investing the ESOP funds in Statewide stock. He also contends that the district court should not have dismissed his purported claim that the Committee violated ERISA by failing to file a securities fraud action on behalf of the plan. He does not challenge the dismissal of the securities fraud suit, and, though he is not entirely clear on this point, does not appear to challenge the district court's conclusions concerning the Committee's alleged misrepresentations and omissions. Thus, in his brief he recites that he appeals from the summary judgment on counts 1, 2, and 4 but not from the summary judgment on counts 3 and 5 of the amended complaint. We have jurisdiction pursuant to 28 U.S.C. § 1291. The district court exercised jurisdiction under 28 U.S.C. § 1331 and 29 U.S.C. § 1132(e). We exercise plenary review over the district court's grant of summary judgment.

II. Discussion

A. Introduction: ERISA's Broad Purpose

Congress enacted ERISA in 1974, "after 'almost a decade of studying the Nation's private pension plans' and other employee benefit plans." *Central States, Southeast and Southwest Areas Pension Fund v. Central Transp., Inc.*, 472 U.S. 559, 569, 105 S.Ct. 2833, 2839, 86 L. Ed. 2d 447 (1985) (quoting *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 361, 100 S.Ct. 1723, 1726, 64 L. Ed. 2d 354 (1980)). Noting the rapid growth of such plans,

Congress set out to "'assure the equitable character of [employee benefit plans] and their financial soundness.'" *Central States*, 472 U.S. at 570, 105 S.Ct. at 2840 (quoting statute) (alterations in original). ERISA seeks to accomplish this goal by requiring such plans to name fiduciaries and by giving them strict and detailed duties and obligations. Specifically, ERISA requires benefit plans to "provide for one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation and administration of the plan." 29 U.S.C. § 1102(a) (1). An ERISA fiduciary "shall discharge his duties . . . solely in the interest of the participants and beneficiaries" and must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B). These requirements generally are referred to as the duties of loyalty and care, or as the "solely in the interest" and "prudence" requirements. This case requires us to decide how these requirements apply to fiduciaries of ESOP plans.

B. Are Defendants Fiduciaries as to Investment Decisions?

Before considering the substantive questions on this appeal, we must address the Committee's argument that for the purposes of this lawsuit, dealing principally with investment decisions, its members are not ERISA fiduciaries, but rather either the Trustee or Statewide was the fiduciary with respect to investments. Under ERISA, "a person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control

respecting management of such plan or exercises any authority or control respecting management or disposition of its assets . . . or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. § 1002(21)(A). As these definitions imply, "'fiduciary status . . . is not an "all or nothing concept . . . . [A] court must ask whether a person is a fiduciary with respect to the particular activity in question."'" *Maniace v. Commerce Bank of Kansas City, N.A.*, 40 F.3d 264, 267 (8th Cir. 1994) (quoting *Kerns v. Benefit Trust Life Ins. Co.*, 992 F.2d 214 (8th Cir. 1993)) (first alteration added), *cert. denied*, 115 S.Ct. 1964 (1995); *American Fed'n of Unions Local 102 Health and Welfare Fund v. Equitable Life Assurance Soc'y of the United States*, 841 F.2d 658, 662 (5th Cir. 1988) ("A person is a fiduciary only with respect to those portions of a plan over which he exercises discretionary authority or control."). The Statewide ESOP, like most benefit plans, names several fiduciaries and allocates duties among them.

The Committee's argument that it was not the fiduciary *vis a vis* investment decisions faces a procedural hurdle because it did not advance that position before the district court. To the contrary, in its "Brief in Support of Defendants' Cross-Motion for Summary Judgment," the Committee stated the following:

> Plaintiff has filed a motion for Summary Judgment on the issue of whether the defendants were fiduciaries. Defendants do not dispute that they were fiduciaries of the ESOP. However, defendants argue that they did not breach any of their fiduciary duties.

Dist. Ct. Br. at 1. Based on this representation, the district court quite naturally interpreted the Committee's admission consistently with the relief Moench sought in his motion. In that motion, Moench sought a partial summary judgment declaring that the Committee members were fiduciaries *vis a vis*, among other things, investment decisions regarding the ESOP. See Memorandum in Support of Plaintiff's Motion for Partial Summary Judgment at 1 ("the members of the committee were given the power to, *inter alia*, . . . create investment guidelines for the ESOP, appoint investment mangers for the ESOP . . . ."). After all, that is what this case always has been about. Thus, in the absence of any distinctions or qualifications drawn by the Committee with respect to the capacities in which its members were fiduciaries, the court granted Moench's motion and treated the Committee members as fiduciaries *vis a vis* investment decisions.

At the very least, then, the Committee failed to raise before the district court the argument that its members were not fiduciaries regarding investment decisions. This omission is decisive for "it is well established that failure to raise an issue in the district court constitutes a waiver of the argument." *American Cyanamid Co. v. Fermenta Animal Health Co.*, 54 F.3d 177, 187 (3d Cir. 1995) (quoting *Brenner v. Local 514, United Bhd. of Carpenters and Joiners of America*, 927 F.2d 1283, 1298 (3d Cir. 1991)).

In fact, the Committee's representation in the district court, when read in conjunction with the arguments it advanced in its district court brief, shows that it actually conceded that its members were fiduciaries *vis a vis* investment decisions. The Committee did not qualify the

concession it made at the outset of its brief. To the contrary, in the argument section, the Committee contended that it "had absolutely no [discretion] regarding where to invest the plan's assets," br. at 8, and that "the [Committee] had no choice except to continue purchasing Statewide stock." Br. at 16. In other words, the Committee conceded that it was responsible for making investment decisions but argued that by complying with the ESOP provisions it complied with ERISA's fiduciary requirements. Thus, the Committee is changing course when it now argues that either the Trustee or the Sponsor was the fiduciary regarding investing the ESOP assets and that it was simply not an ERISA fiduciary in the relevant capacity. We will not permit this. *See Eichleay Corp. v. International Ass'n of Iron Workers*, 944 F.2d 1047, 1056 n. 9 (3d Cir. 1991), *cert. dismissed*, 503 U.S. 915, 112 S.Ct. 1285 (1992); *Cowgill v. Raymark Indus., Inc.*, 832 F.2d 798, 803 (3d Cir. 1987). Thus, we hold that the Committee acted in a fiduciary capacity regarding decisions about how to invest the ESOP assets.[2] We next turn to the district court's grant of the Committee's motion for summary judgment.

C. The Committee's Duties Under ERISA

The first issue we address is the one on which the district court focused -- the requirements of the Statewide ESOP and ESOPs generally. This inquiry raises the following

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[2] For the reasons set forth later in this opinion, Judge Mansmann agrees that the Committee acted in a fiduciary capacity regarding investment decisions of the ESOP assets. She does not believe, however, that the Committee conceded the point since it maintained from the commencement of the suit that the ESOP documents did not grant it discretion in the investment of the plan's assets.

questions: (1) Did the district court err in concluding that the Committee was required by the plan to invest the plan assets in Statewide stock; (2) If so, was the Committee nevertheless constrained by the nature of ESOPs themselves to invest solely in Statewide stock?; (3) If the plan required the Committee to invest in Statewide stock, did its fiduciary responsibilities under ERISA nevertheless require it to ignore the provisions of the plan and to diversify the plan's investments?

1. The district court's decision

The district court concluded that the plan documents mandated that the Committee invest the ESOP assets solely in Statewide stock, and thus it granted the Committee's motion for summary judgment. It appears that in reaching this result the court deferred to the Committee's interpretation of the plan. Specifically, it held that "judicial review of the decisions of fiduciaries in the exercise of their powers is highly deferential and will be upheld unless the decisions are shown to be arbitrary and capricious, not supported by substantial evidence, or erroneous on a question of law." Op. at 11. Against this backdrop, it reasoned:

> the terms of the Plan required [the Committee] to invest the Plan funds in Statewide Bancorp Common Stock within 30 days after the end of the month in which the funds were received. It is clear by the terms of the Plan that it did not afford any discretion in directing the investment of the Plan funds in any other manner.

Op. at 11-12.

Therefore, we initially must decide the scope of a court's review over an ERISA fiduciary's decisions. Moench and his amici argue that the district court applied an incorrect standard of review, as in their view, in cases not involving a trustee's decision to deny benefits to a particular beneficiary, courts do not apply the deferential arbitrary and capricious standard. Rather, they contend that the courts in such cases apply the prudent person standard.

2. The Scope of Review Over an ERISA Fiduciary's Decisions

Moench relies heavily on *Struble v. New Jersey Brewery Employees' Welfare Trust Fund*, 732 F.2d 325 (3d Cir. 1984), to support his argument that the arbitrary and capricious standard does not apply. In that case, the plaintiff beneficiaries charged the defendant trustees with breaching their fiduciary obligations under ERISA by failing to collect employer contributions to the plan and by applying surpluses to benefit the employers rather than the retirees. The defendants argued that the court only should have asked whether their actions were arbitrary or capricious.

At that point in ERISA's history, courts routinely borrowed the "arbitrary and capricious" standard of review governing claims brought under section 302(c)(5) of the Labor Management Relations Act, a statute that permits employer contributions to a welfare trust fund "only if the contributions are used 'for the sole and exclusive benefit of the employees . . . .'" *Struble*, 732 F.2d at 333 (citing LMRA). After surveying the ERISA caselaw, we observed that "although the courts have described the applicability of the arbitrary and capricious standard in rather overbroad language, they nonetheless have limited the use of the

standard to cases involving personal claims for benefits. In other cases they have consistently applied the standards set forth explicitly in ERISA." *Id.* And, we reasoned, there exists a qualitative difference between a personal claim for benefits and a contention that an ERISA trustee failed to act in the interest of the beneficiaries at all. We explained:

> In actions by individual claimants challenging the trustees' denial of benefits, the issue is not whether the trustees have sacrificed the interests of the beneficiaries as a class in favor of some third party's interests, but whether the trustees have correctly balanced the interests of present claimants against the interests of future claimants. . . . In such circumstances it is appropriate to apply the more deferential 'arbitrary and capricious' standard to the trustees' decisions. In the latter type of action, the gravamen of the plaintiff's complaint is not that the trustees have incorrectly balanced valid interests, but rather that they have sacrificed valid interests to advance the interests of non-beneficiaries.

Id. at 333-34. Because in Struble "the plaintiffs alleged that the Employer Trustees voted to give the . . . surplus to the Employers and to reduce the Employers' contributions in order to promote the Employers' interests rather than the retirees' interests," *id.* at 334, we held that the trustees' actions were subject to the prudent person standard. We then applied a de novo standard of review.

Although the plaintiff and their amici urge the mechanical application of Struble here, the facts of that case are not directly apposite. Struble involved a decision by an ERISA

fiduciary to give a benefit to the employer rather than to the beneficiary -- the fiduciary was required to decide which of two classes to favor. And a decision in favor of one class necessarily meant that the other class "lost," that is, could not share in the benefit. When the fiduciary's alignment with the the employer class was added to the mix, its stark, conflicted position became evident. Here, by contrast, Moench does not contend that the Committee's interpretation of the plan and its investment decisions favored non-beneficiaries at the necessary expense of beneficiaries. Rather, the Committee's interpretation of the plan and its investment decisions occurred prior to, as well as during, the period in which Statewide declined financially. Thus, the Committee did not engage in the kind of zero-sum, conflicted analysis that we looked at so warily in Struble. Actually, Moench's conflict of interest allegations really go to the second issue raised on appeal -- that the Committee members' positions as Statewide directors as well as ESOP fiduciaries made impartial decision-making regarding whether to pursue an action on behalf of the ESOP impossible. *See* typescript, *infra*, at 35-36. Moreover, unlike the situation in Struble, the Committee's investment decision was squarely in keeping with the purpose of all ESOP plans.

While *Struble* does not directly control, we must inquire whether its reasoning properly may be expanded to the facts here after *Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. 101, 109 S.Ct. 948, 103 L. Ed. 2d 80 (1989), a case in which the Supreme Court addressed the standard of review governing claims for benefits under 29 U.S.C. § 1132(a)(1)(B). We turn to that case now.

The *Firestone* Court began its analysis by addressing ERISA decisions borrowing the LMRA standard of review. The Court pointed out that the arbitrary and capricious standard of review under the LMRA arose in large part because the LMRA did not provide for judicial review of decisions of LMRA trustees. Thus, the courts adopted the deferential standard of review "as a means of asserting jurisdiction over suits under § 186(c) by beneficiaries of LMRA plans who were denied benefits by trustees." *Id.* at 109, 109 S.Ct. at 953. ERISA, on the other hand, explicitly authorizes private causes of action. Therefore, "the raison d'etre for the LMRA arbitrary and capricious standard . . . is not present in ERISA." *Id.* at 110, 109 S.Ct. at 954.

However, after declining to apply the LMRA caselaw, the *Firestone* Court did not assume that the strict standards of ERISA necessarily should be applied in a de novo fashion. To the contrary, the Court proceeded to point out that "ERISA abounds with the language and terminology of trust law" and that "ERISA's legislative history confirms that the Act's fiduciary responsibility provisions . . . 'codify and make applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts.'" *Id.* (citation omitted) (elipses added). The Court previously had interpreted the statute and its legislative history as authorizing courts to develop a "'federal common law of rights and obligations under ERISA-regulated plans,'" *id.* (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 56, 107 S.Ct. 1549, 1558, 95 L. Ed. 2d 39 (1987)), and in *Firestone* the Court further held that "in determining the appropriate standard of review for actions under § 1132(a)(1)(B), we are guided by principles of trust law." *Id.* at 111, 109 S.Ct. at 954.

After examining the common law of trusts, the Court concluded that the language of the trust controls the ultimate standard of judicial review. Thus, "'where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court except to prevent an abuse by the trustee of his discretion.'" *Id.* (quoting Restatement (Second) of Trusts § 187 (1959)). However, where the trust agreement does not give the trustee power to construe uncertain provisions of the plan, or to make eligibility determinations, the trustee is not entitled to deference and courts exercise de novo review. *Id.* at 111-12, 109 S.Ct. at 955.

Firestone's analytical framework mandates a fresh look at the appropriate standard of review in light of the particular action being challenged. After all, *Firestone* seemed to require courts in all ERISA cases to examine the common law of trusts for guidance in determining the scope of review over a particular ERISA question. The situation is complicated, however, by *Firestone*'s caveat at its outset that "the discussion which follows is limited to the appropriate standard of review in § 1132(a)(1)(B) actions challenging denials of benefits based on plan interpretations." *Id.* at 108, 109 S.Ct. at 953. The Court then continued, "we express no view as to the appropriate standard of review for actions under other remedial provisions of ERISA." *Id.*

A number of courts, relying on *Firestone*'s express limitation, have refused to apply the arbitrary and capricious standard of review to ERISA cases falling outside the category of claims for benefits even though the fiduciary involved had discretionary powers. For instance, in *Ches v. Archer*, 827 F. Supp. 159 (W.D.N.Y. 1993), the plaintiffs

alleged that the plan administrators violated ERISA by refusing to enforce a contribution agreement against an employer. The administrators urged that *Firestone* compelled application of the arbitrary and capricious standard of review, because the plan granted them broad discretion in their administration of the plan. The court, relying primarily on Struble, rejected the argument:

> [T]he discussion in *Firestone* was expressly limited to the appropriate standard of review in actions challenging denials of benefits based on plan interpretations, . . . and its holding therefore does not encompass the present case where the fiduciaries' failure to enforce the contribution payments agreement is challenged. . . . In evaluating fiduciaries' administration of ERISA plans, courts have typically applied the stricter, statutory standard of care, limiting the applicability of the more lenient, arbitrary and capricious standard only to cases where the legality of the trustees' benefit determination was at issue.

Id. at 165. More recently the Court of Appeals for the Second Circuit, relying in part on *Ches v. Archer*, interpreted *Firestone* narrowly and explicitly held that the Struble holding survived the Supreme Court's decision. In that case, *John Blair Communications, Inc. Profit Sharing Plan v. Telemundo Group, Inc. Profit Sharing Plan*, 26 F.3d 360 (2d Cir. 1994), a profit sharing plan brought an ERISA claim against the committee charged with administering the plan, and alleged that by allocating certain surpluses as an employer contribution rather than to the individual beneficiaries' accounts, the committee violated its fiduciary

obligations under ERISA. The court "declined to apply the arbitrary and capricious standard to the fiduciary conduct at issue here because this case does not involve a simple denial of benefits, over which the plan administrators have discretion." *Id.* at 369. Rather, the court held that "*Firestone*'s proposition that the more lenient arbitrary and capricious standard applies where the plan grants discretion to the administrators does not alter Struble's holding that decisions that improperly disregard the valid interest of beneficiaries in favor of third parties remain subject to the strict prudent standard articulated in § 404 of ERISA." *Id.* In reaching its decision, the court expressed concern about the policy implications of expanding *Firestone*'s reach: "Any other rule would allow plan administrators to grant themselves broad discretion over all matters concerning plan administration, thereby eviscerating ERISA's statutory command that fiduciary decisions be held to a strict standard." *Id.*

We agree with these courts that the arbitrary and capricious standard of review allowed in *Firestone* should not be applied mechanically to all ERISA claims, and that claims analogous to those addressed by Struble merit de novo review. But that does not mean that *Firestone* has nothing to say about ERISA claims falling outside the purview of section 1132(a)(1)(B) and not controlled by Struble. While the *Firestone* Court "expressed no view as to the appropriate standard of review for actions under other remedial provisions of ERISA," *id.* at 108, 109 S.Ct. at 953, the Court's mode of analysis is certainly relevant to determine the standard of review pertaining to all claims filed under ERISA challenging a fiduciary's performance. Specifically, the Court looked to trust law in large part

because the terms used throughout ERISA -- participant, beneficiary, fiduciary, trustee, fiduciary duties -- are the "language and terminology of trust law." *Firestone*, 489 U.S. at 110, 109 S.Ct. at 954. That being the case, we believe that after *Firestone*, trust law should guide the standard of review over claims, such as those here, not only under section 1132(a)(1)(B) but also over claims filed pursuant to 29 U.S.C. § 1132(a)(2) based on violations of the fiduciary duties set forth in section 1104(a). After all, section 1104(a) also abounds with the language of trust law, and the Supreme Court previously has noted that "Congress invoked the common law of trusts to define the general scope of [fiduciaries'] authority and responsibility." *Central States*, 472 U.S. at 570, 105 S.Ct. at 2840. Indeed, in *Central States*, the Court went on to say that "the manner in which trustee powers may be exercised . . . is further defined in the statute through the provision of strict standards of trustee conduct, also derived from the common law of trusts -- most prominently, a standard of loyalty and a standard of care." *Id.*; *see also Acosta v. Pacific Enter.*, 950 F.2d 611, 618 (9th Cir. 1991) ("common law trust principles animate the fiduciary responsibility provisions of ERISA.").

Our conclusion is supported by a recent decision by the Court of Appeals for the First Circuit discussing both *Firestone* and *Struble*. In that case, *Mahoney v. Board of Trustees*, 973 F.2d 968 (1st Cir. 1992), the plaintiffs claimed that the trustees of a plan violated ERISA by increasing the size of retirement pensions unevenly, in a manner that "treated longshoremen who had already retired less favorably than those who were still working." *Id.* at 969. The plaintiffs, relying in part on Struble, contended that because several of the trustees were working longshoremen, who

benefitted from the trustees' decision, the court should apply "an especially strict standard of review." *Id.* at 970. The court disagreed, noting that in determining the appropriate standard of review after *Firestone*, trust law "guides, but does not control, our decision." *Id.* at 971. The court then reviewed ordinary principles of trust law, as well as cases applying common law trust principles in analogous situations, and concluded that even though the trustees arguably made a decision to benefit themselves rather than the plaintiff class, trust law permitted them to be beneficiaries of the plan. Therefore, as long as they were making discretionary decisions, the arbitrary and capricious standard of review applied.

3. The Scope of Review Over the Committee's Interpretation

In this case, *Firestone* itself gives us guidance as to the standard of review over the Committee's interpretation of the plan. The Supreme Court's analysis of trust law led it to the conclusion that "[a] trustee may be given power to construe disputed or doubtful terms, and in such circumstances the trustee's interpretation will not be disturbed if reasonable." *Firestone,* 489 U.S. at 111, 109 S.Ct. at 954. This conclusion is in accord with general principles of trust law, which provide that "where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion." Restatement (Second) of Trusts § 187. Indeed, in Central States, the Court gave significant weight to the trustees' interpretation of the trust agreement, because "the trust agreement explicitly provided that 'any construction [of the agreement's provisions]

adopted by the Trustees in good faith shall be binding upon the Union, Employees and Employers.'" *Central States*, 472 U.S. at 568, 105 S.Ct. at 2839 (first alteration added).

Here, the plan gave the Committee unfettered discretion to interpret its terms; it further provided that the Committee's interpretations are conclusive. Thus, assuming that the Committee interpreted the plan, the arbitrary and capricious standard applies and we will disturb its interpretation only if its reading of the plan documents was unreasonable.[3]

In this regard, the Court of Appeals for the Eighth Circuit has enumerated a series of helpful factors to consider in determining whether an interpretation of a plan is reasonable:

> (1) whether the interpretation is consistent with the goals of the Plan; (2) whether it renders any language in the Plan meaningless or internally inconsistent; (3) whether it conflicts with the substantive or procedural requirements of the ERISA statute; (4) whether the [relevant entities have] interpreted the provision at issue consistently; and (5) whether the interpretation is contrary to the clear language of the Plan.

Cooper Tire & Rubber Co. v. St. Paul Fire & Marine Ins. Co., 48 F.3d 365, 371 (8th Cir. 1995) (citing *Finley v. Special Agents Mut. Benefit Ass'n*, 957 F.2d 617, 621 (8th

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[3] Our result is in complete harmony with the prudent man standard of care obligations imposed by 29 U.S.C. § 1104 on fiduciaries, as our holding implicates only the standard of review of the conduct of a fiduciary and not the standards governing that conduct.

Cir. 1992)). The first factor clearly weighs in favor of the interpretation suggested by the Committee during the course of this litigation in both the district court and on appeal, i.e., that it was required without any discretion to invest in Statewide stock. As the district court recognized, ESOP plans are formulated with the primary purpose of investing in employer securities. That being the case, the Committee's interpretation is consistent with the purpose of the trust. *See* Restatement (Second) of Trusts § 187 Comment d (court should consider "the purposes of the trust" in determining whether trustee has abused the discretion conferred on him or her by the terms of the plan.).

However, the Committee's purported interpretation renders other language in the plan documents meaningless. For instance, the plan documents state that assets are to be invested *primarily* in Statewide stock. Therefore, it seems counterintuitive for the Committee to interpret the plan as requiring it to invest *exclusively* in Statewide stock. More importantly, the history of the Trustee's investment decisions -- actually relied upon by the Committee -- belie the reasonableness of the Committee's interpretation. The Committee concedes in its brief (apparently without realizing the consequences) that "in March, 1991 . . . the Trust Division voted not to invest any more money in Statewide's stock until the issue was clarified and instead held the fund in money market instruments." Br. at 11. With this statement, the Committee admits that the plan has been interpreted -- by the entity investing the assets -- as permitting the Trustee to refrain from investing the plan assets in Statewide stock. Therefore, the language of the trust documents has not been interpreted consistently in the manner the Committee suggests. Similarly, the Committee

makes inconsistent arguments on this appeal, which make us wary of adopting its interpretation. On the one hand, it argues that the plan documents did not permit it to invest in securities other than Statewide stock. On the other, it argues that it could diversify the investments only when information about Statewide's impending collapse became public.

Finally, the Committee's interpretation, particularly in light of the ambiguous language of the plan, is inconsistent with ERISA inasmuch as it constrains the Committee's ability to act in the best interest of the beneficiaries. *Kuper v. Quantum Chem. Corp.*, 852 F. Supp. 1389, 1395 (S.D. Ohio 1994) (ESOP plan "must be interpreted, consistent with ERISA to provide that the . . . ESOP fiduciaries did possess discretion to place ESOP funds into investments other than [employer] stock, in the event that the interests of the plan participants and beneficiaries so required"); *cf.* Restatement (Third) of Trusts § 228(a) ("In investing the funds of the trust, the trustee has a duty to the beneficiaries to conform to any applicable statutory provisions governing investment by trustees."). Moreover, as we discuss more fully below, it is at odds with a fiduciary's responsibility under the common law of trusts, which mandates that the trustee in certain narrow instances must take actions at odds with how it is directed generally to act. Therefore, the Committee's interpretation of the plan is unreasonable and we reject it.[4]

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[4] In view of our result, we are not concerned with a situation in which an ESOP plan in absolutely unmistakeable terms requires that the fiduciary invest the assets in the employer's securities regardless of the surrounding circumstances. Consequently, we should not be understood as suggesting that there never could be a breach of fiduciary duty in such a case. We similarly do not reach Moench's argument that if the plan directed the Committee to invest the funds

We need not rely solely on the unreasonableness of the Committee's interpretation during this litigation, however, because the record is devoid of any evidence that the Committee construed the plan at all. Thus, this is not a case implicating the arbitrary and capricious standard of review. The Committee points to nothing in the record indicating that it -- the Committee -- actually deliberated, discussed or interpreted the plan in any formal manner. To the contrary, in support of its supposed interpretation, the Committee cites actions taken by the Pension and Benefits Committee of Statewide, which it concedes "was an entity separate and distinct from the Plan Committee comprised of the defendants," br. at 9, and actions taken by the "Trust Division of FNBTR, the Trustee of the Plan," br. at 10, which also was not the Committee in charge of construing the terms of the plan. The deferential standard of review of a plan interpretation "is appropriate only when the trust instrument allows the trustee to interpret the instrument and when the trustee has in fact interpreted the instrument." *Trustees of Central States, Southeast and Southwest Areas Health and Welfare Fund v. State Farm Mut. Auto Ins. Co.*, 17 F.3d 1081, 1083 (7th Cir. 1994) (emphasis added). As the Restatement (Second) of Trusts § 187, comment (h) puts it:

> The court will control the trustee in the exercise of a power where its exercise is left to the judgment of the trustee and he fails to use his judgment. Thus, if the trustee without knowledge of or inquiry into

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solely in Statewide stock, ERISA nevertheless required the Committee to ignore the plan terms when those terms conflicted with its fiduciary obligations under ERISA.

> the relevant circumstances and merely as a result of his arbitrary decision or whim exercises or fails to exercise a power, the court will interpose.

Here, there is no indication that the Committee actually made an effort to construe the plan. In the absence of such evidence:

> 'The extent of the duties and powers of a trustee is determined by rules of law that are applicable to the situation, and not the rules that the trustee or his attorney believes to be applicable, and by the terms of the trust as the court may interpret them, and not as they may be interpreted by the trustee or by his attorney.'

Firestone, 489 U.S. at 112, 109 S.Ct. at 955 (citation omitted).

As such, applying a de novo interpretation of the plan, we have no hesitation concluding that the Statewide ESOP, while designed with the primary purpose of investing in Statewide securities, did not absolutely require the Committee to invest exclusively in Statewide stock.[5] We therefore believe that the district court erred in determining that the Committee had no latitude but to continue investing in Statewide stock.

The Committee nevertheless argues that it cannot be liable under ERISA because, consistent with the nature of ESOPs themselves, it cannot be accountable for investing the assets solely in Statewide stock. We turn to that argument now,

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[5] As we have explained, we would have reached the same result applying the arbitrary and capricious standard of review.

which again requires a detailed inquiry into the standard of review over an ESOP fiduciary's decisions.

4. ESOPs and ERISA

a. General policies and the developed caselaw

ERISA contains specific provisions governing ESOPs. While fiduciaries of pension benefit plans generally must diversify investments of the plan assets "so as to minimize the risk of large losses," see section 1104(a)(1)(C), fiduciaries of ESOPS are exempted from this duty. Specifically, "the diversification requirement . . . and the prudence requirement (only to the extent that it requires diversification) . . . is not violated by acquisition or holding of . . . qualifying employer securities . . . ." 29 U.S.C. § 1104(a)(2). In other words, under normal circumstances, ESOP fiduciaries cannot be taken to task for failing to diversify investments, regardless of how prudent diversification would be under the terms of an ordinary non-ESOP pension plan. ESOPs also are exempted from ERISA's "strict prohibitions against dealing with a party in interest, and against self-dealing, that is, 'deal[ing] with the assets of the plan in his own interest or for his own account.'" *Martin v. Feilen*, 965 F.2d 660, 665 (8th Cir. 1992) (citing 29 U.S.C. § 1106(b)(1)), *cert. denied*, 113 S.Ct. 979 (1993).

The reason for these specific rules arises out of the nature and purpose of ESOPs themselves. "[E]mployee stock ownership plan[s are] designed to invest primarily in qualifying employer securities." 29 U.S.C. § 1107(d)(6)(A). Thus, unlike the traditional pension plan governed by ERISA, ESOP assets generally are invested "in securities

issued by [the plan's] sponsoring company," *Donovan v. Cunningham*, 716 F.2d 1455, 1458 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251, 104 S.Ct. 3533, 82 L. Ed. 2d 839 (1984). In keeping with this, ESOPs, unlike pension plans, are not intended to guarantee retirement benefits, and indeed, by its very nature "an ESOP places employee retirement assets at much greater risk than does the typical diversified ERISA plan." *Martin v. Feilen*, 965 F.2d at 664. The summary plan description in this case, for example, explicitly stated that the plan "does not provide for a guaranteed benefit at retirement." App. 174.

Rather, ESOPs serve other purposes. Under their original rationale, ESOPS were described "as . . . device[s] for expanding the national capital base among employees -- an effective merger of the roles of capitalist and worker." *Donovan v. Cunningham*, 716 F.2d at 1458. Thus, the concept of employee ownership constituted a goal in and of itself. To accomplish this end, "Congress . . . enacted a number of laws designed to encourage employers to set up such plans." *Id.* The Tax Reform Act of 1976 was one of those statutes, and in passing it, Congress explicitly stated its concern that courts should refrain from erecting barriers that would interfere with that goal:

> 'The Congress is deeply concerned that the objectives sought by [the series of laws encouraging ESOPs] will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take the necessary steps to implement the plans, and which otherwise block the

establishment and success of these plans.'

Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1590 (1976) (quoted in *Donovan v. Cunningham*, 716 F.2d at 1466 n.24).

Notwithstanding all of this, ESOPs are covered by ERISA's stringent requirements, and except for a few select provisions like the ones we quote above, ESOP fiduciaries must act in accordance with the duties of loyalty and care. In other words, "Congress expressly intended that the ESOP would be both an employee retirement benefit plan and a 'technique of corporate finance' that would encourage employee ownership." *Martin v. Feilen*, 965 F.2d at 664 (quoting 129 Cong. Rec. S16629, S16636 (Daily ed. Nov. 7, 1983) (statement of Sen. Long)). ESOP fiduciaries must, then, wear two hats, and are "expected to administer ESOP investments consistent with the provisions of both a specific employee benefits plan and ERISA." *Kuper v. Quantum Chem. Corp.*, 852 F. Supp. at 1395.

All of this makes delineating the responsibilities of ESOP trustees difficult, because they "must satisfy the demands of Congressional policies that seem destined to collide." *Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983) (footnotes omitted), *cert. denied*, 467 U.S. 1251, 104 S.Ct. 3533, 82 L. Ed. 2d 839 (1984). As the Cunningham court explained:

> On the one hand, Congress has repeatedly expressed its intent to encourage the formation of ESOPs by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that

> goal. Competing with Congress' expressed policy to foster the formation of ESOPs is the policy expressed in equally forceful terms in ERISA: that of safeguarding the interests of participants in employee benefit plans by vigorously enforcing standards of fiduciary responsibility.

Id. See also Martin v. Feilen, 965 F.2d at 665 ("the special statutory rules applicable to ESOPs inevitably affect the fiduciary's duties under § 1104"); *Kuper*, 852 F. Supp. at 1394 (quoting *Cunningham*). So with the goals of ESOPs on the one hand, and ERISA's stringent fiduciary duties on the other, the courts' "task in interpreting the statute is to balance these concerns so that competent fiduciaries will not be afraid to serve, but without giving unscrupulous ones a license to steal." *Donovan v. Cunningham*, 716 F.2d at 1466. The goals of the two statutes often serve consistent ends -- ensuring that the fiduciary acts in the interest of the plan -- and in those cases the nature of a plaintiff's claim will not create tension. But when the plaintiff claims that an ESOP fiduciary violated its ERISA duties by continuing to invest in employer securities, the conflict becomes particularly stark.

Nevertheless, cases addressing the duties of ESOP fiduciaries in this area generally have allowed ERISA's strict standards to override the specific policies behind ESOPs. In *Eaves v. Penn*, 587 F.2d 453 (10th Cir. 1978), for example, an ESOP fiduciary argued that he was bound by both the terms of the ESOP plan and ERISA itself to invest the plan assets in employer securities. The court, relying extensively on the legislative history underlying ERISA, interpreted the statutory exception as only prohibiting per se liability based

on failure to diversify. It justified this conclusion by reasoning that "the structure of the Act itself requires that in making an investment decision of whether or not a plan's assets should be invested in employer securities, an ESOP fiduciary, just as fiduciaries of other plans, is governed by the 'solely in the interest' and 'prudence' tests. . . ." *Id.* at 459.

Other decisions are more specific and have held that notwithstanding ERISA's diversification provisions, an ESOP fiduciary must diversify if diversification is in the best interests of the beneficiaries. The Court of Appeals for the District of Columbia Circuit has stated:

> The requirement of prudence in investment decisions and the requirement that all acquisitions be solely in the interest of plan participants continue to apply. The investment decisions of a profit sharing plan's fiduciary are subject to the closest scrutiny under the prudent person rule, in spite of the 'strong policy and preference in favor of investment in employer stock.'

Fink v. National Sav. and Trust Co., 249 U.S. App. D.C. 33, 772 F.2d 951, 955-56 (D.C. Cir. 1985) (citations omitted). And in an opinion heavily relied upon by Moench and his amici, a district court in this circuit has held that the ERISA provisions exempting ESOP fiduciaries from the duty to diversify "merely entail that 'acquisition of employer securities . . . does not, in and of itself, violate any of the absolute prohibitions of ERISA.'" *Canale v. Yegen*, 782 F. Supp. 963, 967 (D.N.J. 1992) (quoting *Fink*, 772 F.2d at 955), *reargument denied in part, granted in part*, 789 F. Supp. 147 (D.N.J. 1992). Rather, the court continued, "the

allegation that [an ESOP] administrator has failed to prudently diversify plan assets invested exclusively in the stock of the beneficiaries' employer can state a claim for breach of fiduciary duties under ERISA." *Id.* at 967-68.

Notwithstanding the fact that none of these decisions specifically delineate a standard of review, Moench and his amici read these cases as requiring that a court not be deferential when reviewing an ESOP fiduciary's actions in investing in employer securities. There are numerous problems with their argument. First, by subjecting an ERISA fiduciary's decision to invest in employer stock to strict judicial scrutiny, we essentially would render meaningless the ERISA provision excepting ESOPs from the duty to diversify. Moreover, we would risk transforming ESOPs into ordinary pension benefit plans, which then would frustrate Congress' desire to encourage employee ownership. After all, why would an employer establish an ESOP if its compliance with the purpose and terms of the plan could subject it to strict judicial second-guessing? Further still, basic principles of trust law require that the interpretation of the terms of the trust be controlled by the settlor's intent. That principle is not well served in the long run by ignoring the general intent behind such plans in favor of giving beneficiaries the maximum opportunities to recover their losses.

In short, the sheer existence of ESOPs demonstrates that there is some value in employee ownership per se, even though participants inevitably run some risk in terms of their financial gain. Therefore, the policies behind ERISA's rules governing pension benefit plans cannot simply override the goals of ESOPs, and courts must find a way for the

competing concerns to coexist. Indeed, the position taken by Moench and the Secretary of Labor leaves numerous questions unanswered: How is an ESOP fiduciary to determine when diversification is in the best interest of the beneficiaries? Is the fiduciary always to seek the return-maximizing investment, or is there some non-tangible loyalty interest served by retaining ESOP investments in employer stock? Additionally, to what extent should ESOPs be considered retirement plans, notwithstanding the qualification contained in most of them, including Statewide's, that they are not designed to guarantee retirement income? We are uneasy with the answers Moench and the Secretary would give to these questions. Both seem ready and willing to sacrifice the policies behind ESOPs and employee ownership in order to make "ESOP fiduciaries virtual guarantors of the financial success of the [ESOP] plan." Martin v. Feilen, 965 F.2d at 666. That we cannot, should not and will not do.

In this regard, we point out that the participants in the plan effectively became investors in Statewide and thus should have expected to run risks inherent in that role. The Statewide plan was voluntary and the summary plan description provides that "[e]ach individual Employee's account will experience gains or losses according to the performance of the investments held by the Plan. The primary investment of the Plan shall be Statewide Bancorp Common Stock." App. 174. Therefore, the participants should have recognized that the value of their interests was dependent on Statewide's performance.

b. Developing a standard

We again look to trust law for guidance in determining the

standard of review. We can formulate a proper standard of review of an ESOP fiduciary's investment decisions by recognizing that when an ESOP is created, it becomes simply a trust under which the trustee is directed to invest the assets primarily in the stock of a single company. More than that, the trust serves a purpose explicitly approved and encouraged by Congress. Therefore, as a general matter, "ESOP fiduciaries should not be subject to breach-of-duty liability for investing plan assets in the manner and for the . . . purposes that Congress intended." *Martin v. Feilen*, 965 F.2d at 670. And while trustees -- of both ordinary trusts and pension benefit plans -- are under a duty to "diversify the investments of the trust," *see* Restatement (Third) § 227(b), that duty is waivable by the terms of the trust. Section 227(d) ("The trustee's duties under this Section are subject to the rule . . . dealing with contrary investment provisions of a trust or statute."). Seen in light of these principles, the provision in ERISA exempting ESOPs from the duty to diversify is simply a statutory acknowledgement of the terms of ESOP trusts. And the common law of trusts in fact guides us in this difficult area.

The Restatement of Trusts provides that in investing trust funds, "the trustee . . . has a duty to the beneficiaries to conform to the terms of the trust directing . . . investments by the trustee." Restatement (Third) § 228. Thus, "[a]s a general rule a trustee can properly make investments in such properties and in such manner as expressly or impliedly authorized by the terms of the trust." *Id.* comment (d). However, trust law distinguishes between two types of directions: the trustee either may be mandated or permitted to make a particular investment. If the trust requires the fiduciary to invest in a particular stock, the trustee must

comply unless "compliance would be impossible . . . or illegal" or a deviation is otherwise approved by the court. *Id.* comment (e). When the instrument only allows or permits a particular investment, "the fiduciary must still exercise care, skill, and caution in making decisions to acquire or retain the investment." *Id.* comment (f).

In a case such as this, in which the fiduciary is not absolutely required to invest in employer securities but is more than simply permitted to make such investments, while the fiduciary presumptively is required to invest in employer securities, there may come a time when such investments no longer serve the purpose of the trust, or the settlor's intent. Therefore fiduciaries should not be immune from judicial inquiry, as a directed trustee essentially is, but also should not be subject to the strict scrutiny that would be exercised over a trustee only authorized to make a particular investment. Thus, a court should not undertake a de novo review of the fiduciary's actions similar to the review applied in Struble. Rather, the most logical result is that the fiduciary's decision to continue investing in employer securities should be reviewed for an abuse of discretion.

In light of the analysis detailed above, keeping in mind the purpose behind ERISA and the nature of ESOPs themselves, we hold that in the first instance, an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities.

In attempting to rebut the presumption, the plaintiff may introduce evidence that "owing to circumstances not known

to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust." Restatement (Second) § 227 comment g.[6] As in all trust cases, in reviewing the fiduciary's actions, the court must be governed by the intent behind the trust -- in other words, the plaintiff must show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate. In determining whether the plaintiff has overcome the presumption, the courts must recognize that if the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer's securities, it may face liability for that caution, particularly if the employer's securities thrive. See Kuper, 852 F. Supp. at 1395, ("defendants who attempted to diversify its ESOP assets conceivably could confront liability for failure to comply with plan documents").

In considering whether the presumption that an ESOP fiduciary who has invested in employer securities has acted consistently with ERISA has been rebutted, courts should be cognizant that as the financial state of the company deteriorates, ESOP fiduciaries who double as directors of the corporation often begin to serve two masters. And the more uncertain the loyalties of the fiduciary, the less discretion it has to act. Indeed, "'[w]hen a fiduciary has dual loyalties, the prudent person standard requires that he make a careful and impartial investigation of all investment decisions.'"

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[6] This quote derives from the Second Restatement, though the section we quote has been amended by the Restatement (Third) of Trusts.

Martin v. Feilen, 965 F.2d at 670 (citation omitted). As the *Feilen* court stated in the context of a closely held corporation:

> [T]his case graphically illustrates the risk of liability that ESOP fiduciaries bear when they act with dual loyalties without obtaining the impartial guidance of a disinterested outside advisor to the plan. Because the potential for disloyal self-dealing and the risk to the beneficiaries from undiversified investing are inherently great when insiders act for a closely held corporation's ESOP, courts should look closely at whether the fiduciaries investigated alternative actions and relied on outside advisors before implementing a challenged transaction.

Id. at 670-71. And, if the fiduciary cannot show that he or she impartially investigated the options, courts should be willing to find an abuse of discretion.

When all is said and done, this is precisely the argument Moench makes in this case: that the precipitous decline in the price of Statewide stock, as well as the Committee's knowledge of its impending collapse and its members' own conflicted status, changed circumstances to such an extent that the Committee properly could effectuate the purposes of the trust only by deviating from the trust's direction or by contracting out investment decisions to an impartial outsider.

Because the record is incomplete, we cannot determine whether the Committee is entitled to summary judgment. Therefore, we will remand the matter to the district court for further proceedings in which the record may be developed

and the case may be judged on the basis of the principles we set forth.[7]

D. Failure to bring derivative action

Moench and the Secretary of Labor appear to argue that the district court erred by failing to address Moench's claim that the Committee violated ERISA by failing to file a claim against Statewide's directors on behalf of the ESOP.

Actually, Moench's argument is somewhat unclear. In his statement of issues presented, Moench asks whether "ERISA [is] violated when pension plan administrators exonerate themselves of personal liability to the plan by excluding the plan from participation in the settlement of a class action securities fraud suit against some of the plan administrators, and by letting limitations run out without investigating the wisdom of the plan bringing its own securities fraud suit?"[8] Br. at 1. However, the corresponding portion of the brief's argument section is entitled "Failure to have the ESOP pursue any securities fraud claim was a prejudicial and actionable breach of fiduciary duty." Br. at 24 (emphasis added). In that section, Moench argues that "the defendants

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[7] Moench contends that he raised a number of other fiduciary breaches before the district court, independent of the Committee's investment in Statewide stock. Furthermore, Moench contended at oral argument that the Committee engaged in self-dealing prohibited by ERISA. This opinion is limited to the issues discussed; it is up to the district court to determine whether these other claims are adequately plead, and if so, how to proceed with them.

[8] The record shows that a shareholder's derivative action was filed against Statewide, *Lerner v. Statewide Bancorp.*, Civ. No. 90-1552, which named, among others, three of the defendants in this suit. That action eventually settled, and the ESOP was excluded from the settlement.

. . . clearly and unequivocally had a duty to pursue a derivative action against three of their own number as well as the plan sponsor, whom the members served as corporate directors." Br. at 27. For his part, the Secretary of Labor makes a different, more general argument: "The district court did not address the plaintiff's claim that the defendants breached their fiduciary duties under ERISA by failing to take steps on the ESOP's behalf as shareholder to remedy corporate fiduciary breaches committed by FNBTR's directors." Amicus Br. at 23.

The confused arguments urged on this appeal, and the conflicting descriptions of what was raised in the district court, is not surprising, considering that Moench made an entirely different argument before the district court. The issue of the Committee's duty to take affirmative legal action was raised below only as part of a still different argument that "[t]here are numerous questions of fact surrounding defendants' conflict of interest." Plaintiff's Mem. of Law in Opp. to Def. Mot. for Sum. Jud. at 25. Moench argued in the district court that "the defendants, having knowledge that the bank was fraudulently understating the true extent of its financial difficulties, had a duty to act on this knowledge, even if it was not public knowledge. Moreover, this duty *may* have included a duty to bring a derivative action on behalf of the ESOP, even if it meant suing themselves as directors." *Id.* at 29 (emphasis added). It appears from a fair reading of his brief in the district court -- though it is by no means crystal clear -- that Moench was urging that the Committee breached its ERISA duties by failing either to resign as ESOP trustees or to assign the investment decisions to an independent outside source. Thus, Moench concluded the conflict of interest section in the brief below by stating:

"It is submitted that after receipt of the March 1990 OCC report, and the filing of the *Lerner* action, these two duties [of director and ESOP fiduciary] became irreconcilable." *Id.* at 30.

At any rate, our resolution of the issues discussed above, which requires that we vacate the grant of summary judgment and hence resurrects Moench's complaint, makes it unnecessary for us to reach this issue. Upon remand, Moench may seek to file a motion to amend his complaint to make clear precisely what he is arguing on this score.[9]

III. Conclusion

For the foregoing reasons, we will vacate the district court's order of September 21, 1994, granting summary judgment on counts 1, 2, and 4 of the amended complaint, and will remand the matter to the district court for further proceedings consistent with this opinion.

A True Copy

Teste:

Clerk of the United States Court of Appeals for the Third Circuit

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[9] We stress that the standard of review we apply over an ESOP fiduciary's investment decisions does not necessarily apply over a claim that an ESOP fiduciary failed to take action to protect the ESOP assets. If the district court reaches this "failure to sue" issue on remand, it should determine in the first instance the appropriate standard of review. In making that determination, the court should consider whether Struble controls.

Appendix B

Judgment of the Court of Appeals for the Third Circuit
(August 10, 1995)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 94-5637

CHARLES MOENCH in his own right and on behalf of those similarly situated, and on behalf of the Statewide Bancorp Employee Stock Option Plan

v.

JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., RAYMOND A.
TAYLOR, ESTATE OF FRANK EWART, JOHN EWART,
ADMINISTRATOR

Charles Moench, in his own right and on behalf of all those similarly situated, Appellant.

On Appeal from the United States District Court
for the District of New Jersey.
(D.C. No. 92-4829).

Present: Mansmann, Greenberg and Sarokin, Circuit Judges

JUDGMENT

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel on June 26, 1995.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered on September 21, 1994, be, and the same is hereby vacated and the cause is remanded to the district court for further proceedings consistent with the opinion of this Court

ATTEST:

Deputy Clerk

Dated: August 10, 1995

Appendix C

Order of the District Court on Motion to Dismiss
(August 20, 1993)

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

CHARLES MOENCH, in his own right and on behalf of all those similarly situated, and on behalf of the Statewide Bancorp Employee Stock Option Plan,	)	CIVIL ACTION NO: 92-4829 (MLP)
Plaintiff,	)	
v.	)	**MEMORANDUM AND ORDER**
JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., RAYMOND A. TAYLOR,	)	
Defendants.	)	

PARELL, District Judge

This matter comes before the Court on defendants' motion to dismiss the Complaint and plaintiff's motion for class certification. For the reasons set forth in this Memorandum and Order, the Court grants defendants' motion in part and denies it in part. Plaintiff's motion shall be adjourned for additional briefing.

BACKGROUND

Plaintiff Charles Moench was an employee at Statewide Bancorp ("Statewide"), a bank holding company with its principal office in Toms River, New Jersey. As an employee of Statewide, plaintiff became a member of the Employee Stock Ownership Plan (the "Plan").

Statewide had commenced the Plan on January 1, 1986. (Compl. ¶ 17). The Plan was funded by voluntary employee payroll deductions and through Statewide's partial matching of those contributions. (Compl. ¶ 18). Under the terms of the Plan, all investments were required to be in Statewide securities, primarily Statewide common stock. (Compl. ¶ 23).

Statewide ultimately became insol[v]ent, filing a petition under Chapter 11 of the Bankruptcy Code on May 23, 1991. (Compl. ¶ 43). Statewide's bankruptcy filing has resulted in many of its securities being worthless, rendering the Plan's assets substantially diminished. (Compl. ¶ 47).

Plaintiff thus commenced this action on November 11, 1992. The Complaint, styled as both a class action and a stockholder's derivative action, alleges that the Plan's directors breached their fiduciary duties to the Plan and its participants in violation of ¶¶ 1104, 1106, and 1109 of the Retirement Income Security A[c]t ("ERISA"), 29 U.S.C.

§ 1001, et seq. The Complaint names as defendants all Plan directors.

Plaintiff specifically argues that allowing exclusive investment in Statewide's securities, even though the directors were aware of the securities' significant riskiness, constituted a breach of the directors' duty to prudently invest Plan assets. (Compl. Count One). Plaintiff also alleges that defendants falsely represented to the Plan participants that their funds were securely invested. (Compl. Count Three). Plaintiff argues that each director should be liable for the alleged fiduciary breaches of his co-directors. (Compl. Count Two). Counts One through Three are brought as a class-action, and Count Four is brought as a stockholder's derivative suit.

Plaintiff originally moved for class certification on March 26, 1993, and that motion was assigned a return date of April 19, 1993. The parties then agreed to adjourn that motion to June 7, 1993. In the meantime defendants filed a motion to dismiss the Complaint. The parties then consented to have both motions be returnable on July 19, 1993. The Court now decides both motions on the papers pursuant to Fed. R. Civ. P. 78.

DISCUSSION

A. Motion to Dismiss

1. Legal Standard

A court may dismiss a complaint pursuant to Fed. R. Civ. P. 12(b)(6) "only if, accepting all well pleaded facts as true, the plaintiff is not entitled to relief." Bartholomew v. Fischl, 782 F.2d 1148, 1152 (3d Cir. 1986). Additionally,

all reasonable inferences from plaintiff's allegations "must be accepted as true and viewed in the light most favorable to the non-moving party." Sturm v. Clark, 835 F.2d 1009, 1011 (3d Cir. 1987). This Court may not dismiss a complaint unless plaintiff can prove no set of facts which would entitle him to relief. Conley v. Gibson, 355 U.S. 41, 45-46 (1957). "The issue is not whether a plaintiff will ultimately prevail but whether [] the claimant is entitled to offer evidence to support the claims." Scheuer v. Rhodes, 416 U.S. 232, 236 (1974).

2. Merits

a.) Count One

In Count One of the Complaint, plaintiff claims that "defendants' failure to terminate [the Plan] in a timely fashion in order to obtain maximum current value for the securities" constituted a breach of the Plan directors' fiduciary duty. (Comp. ¶ 60).

Regardless of whether terminating or modifying the Plan would have proved to be prudent conduct, such action is not that which is encompassed within a director's fiduciary duties under ERISA. See Hozier v. Midwest Fasteners, Inc., 908 F.2d 1155, 1161 (3rd Cir. 1990) (ERISA fiduciary's duties do not extend to decisions to amend or terminate a plan), citing Sutton v. Weirton Steel Division, 724 F.2d 406 (4th Cir. 1983), cert. denied, 467 U.S. 1205 (1984). Defendants' motion to dismiss Court One of the Complaint is therefore granted.

b.) Counts Two and Three

Count Three alleges that Plan fiduciaries (1) failed to fully

disclose appropriate information to Plan participants, and (2) disclosed inaccurate and misleading information to Plan participants. (Compl. ¶¶ 69-70). Court Two seeks to hold the directors severally liable for the alleged wrongful conduct of their co-directors.

Defendants argue that Counts Two and Three, although styled as class action claims, are actually claims which must be brought in a stockholder's derivative action. In support of that argument, defendants claim that the directors' alleged wrongdoings negatively impacted all the shareholders and that therefore the claim of the stock's diminution in value is a claim shared by all shareholders. Such a claim, according to defendants, is one which must be brought on behalf of the corporation in a stockholder's derivative suit. Defendants then assert various defects in the Complaint warranting dismissal as a derivative action.

Defendants have failed, however, to provide a basis for not applying the fiduciary duties under ERISA which attach to plan directors. In this case, the Plan was a an employee stock ownership plan, as defined in 29 U.S.C. § 1107(d)(6). Under ERISA, the Plant directors owed a fiduciary duty to the Plan and its participants. See 29 U.S.C. § 1104. The fact that the injury suffered by Plan participants, the diminution in the stock's value, mirrored the injury suffered by non-Plan shareholders does not shield Plan directors from liability as ERISA fiduciaries. The directors, if found to have breached a fiduciary duty to Plan participants, may be held liable under ERISA. See 29 U.S.C. § 1109.

This Court passes on neither the legal or factual bases for plaintiff's claims that the directors misinformed Plan participants (Count Three), nor whether each director may

be held liable for the alleged fiduciary breaches of the other directors. (Count Two). This Court holds only that these claims may provide the basis for fiduciary liability under ERISA and need not proceed only in a stockholder's derivative action. The Court therefore denies defendant' motion to dismiss these counts.

c.) Count Four

Defendants argue that plaintiff's Count Four derivative claim should be dismissed for failure to comply with Fed. R. Civ. P. 23.1. Rule 23.1 requires that in a derivative action the complaint

> allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort.

In an apparent attempt to satisfy this requirement, the Complaint states that

> On or about October 23, 1992, the FDIC, the Administrator of the ESOP, after proper notice by plaintiff's counsel, declined to pursue any ERISA based litigation against members of the Plan Committee. (Compl. ¶ 79).

Such a vague, conclusory allegation does not satisfy the particularity requirements of Fed. R. Civ. P. 23.1 See 3B James W. Moore ET AL., Moore's Federal Practice ¶ 23.1.19 (2d ed. 1985) (citing cases dismissing derivative actions for insufficient particularity in demand to corporate directors). Plaintiff has attempted to cure this defect by

submitting a letter from the FDIC which indicates FDIC's support for the litigation, even though FDIC has chosen not to participate in it. (Pl.'s Br. Ex. A). The letter, however, drafted in response to defendants' argument, does not satisfy plaintiff's burden of pleading, with particularity, the demands made to the FDIC prior to commencing the derivative action.

Plaintiff correctly notes in his opposition brief that this "hybrid" pleading requirement (including both a class action under Fed. R. Civ. P. 23 and a derivative action under Rule 23.1) does not appear necessary under precedent in this circuit. See, e.g., McClendon v. Continental Group, Inc., 113 F.R.D. 39 (D.N.J. 1986); Walsh v. Great Atlantic & Pacific Tea Company, Inc., 96 F.R.D. 632 (D.N.J. 1983) (allowing ERISA class actions in the absence of corresponding derivative actions). Plaintiff may therefore continue to pursue his ERISA suit in the absence of this stockholder's derivative Count.

For the foregoing reasons, it therefore appears appropriate to dismiss plaintiff's Count Four derivative claim without prejudice. Should plaintiff elect to amend his Complaint to correct the deficiencies noted with respect to Rule 23.1, the Court will consider the reinstatement of the derivative claim on an appropriate motion.

B. Class Certification

Plaintiff has moved for class certification under Fed. R. Civ. P. 23. In response to that motion, defendants have principally argued that class certification is inappropriate because the action was properly viewed as a shareholder's derivative action. Defendants therefore have not yet addressed the factors under Rule 23 which a court must consider in determining whether to certify a class.

As the Court has now determined that Counts Two and

Three may proceed as ERISA claims, independent of any shareholder derivative action, the Court requests that defendants address the factors under Fed. R. Civ. P. 23 for class certification with respect to those two Counts.

Based on the foregoing,

IT IS on this 17th day of August, 1993 ORDERED that defendants' motion to dismiss Count One of the Complaint be and is hereby GRANTED;

IT IS FURTHER ORDERED that defendants' motion to dismiss Counts Two and Three of the Complaint be and is hereby DENIED;

IT IS FURTHER ORDERED that Count Four of the Complaint be and is hereby DISMISSED WITHOUT PREJUDICE;

IT IS FURTHER ORDERED that plaintiff's motion for class certification be and is hereby adjourned to October 4, 1993;

IT IS FURTHER ORDERED that defendants file with the Court a brief addressing the class action factors under Fed. R. Civ. P. 23 by September 7, 1993; and

IT IS FURTHER ORDERED that plaintiff file its response to defendants' submission regarding Rule 23 by September 21, 1993.

MARY LITTLE PARELL

United States District Judge

Appendix D

Order of the District Court Approving
Class and Derivative Certification
(December 20, 1993)

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY
(TRENTON VICINAGE)

CHARLES MOENCH, et al.	:	
	:	CIVIL ACTION
Plaintiff	:	NO. 92-4829 (MLP)
	:	
v.	:	
	:	
JOSEPH W. ROBERTSON, et al.	:	
	:	
	:	
Defendants	:	

ORDER APPROVING CLASS AND
DERIVATIVE CERTIFICATION

THIS MATTER having come before the Court on motion of the plaintiff for an Order certifying this action as a class action, pursuant to Rules 23 and 23.2 of the Federal Rules of Civil Procedure; and as a derivative action pursuant to Rules 17 and 23.1 of the Federal Rules of Civil Procedure; and

UPON due consideration of all moving papers; and

WHEREAS, defense counsel having no objection to plaintiffs' motion; and

IT APPEARING that the Class defined herein satisfies the requirements of Rules 23(a), 23(b)(1)(B), and 23.2 of the Federal Rules of Civil Procedure in that:

(a) the Class is so numerous that joinder of all members thereof is impracticable;

(b) there are questions of law or fact common to the Class;

(c) the claims of the plaintiff specified above are typical of the claims of the members of the Class he represents;

(d) the plaintiff will fairly and adequately protect the interests of the Class;

(e) the questions of law or fact common to the members of the Class predominate over any questions affecting only individual members; and

(f) the prosecution of separate actions by individual class members would create a risk of adjudications which would, as a practical matter, be dispositive of the interest of the entire Class.

IT IS HEREBY ORDERED AS FOLLOWS:

1. This litigation is certified to proceed as a class action pursuant to Rules 23(b)(1)(B) and 23.2 of the Federal Rules of Civil Procedure, with respect to plaintiff's claims under Counts I, II and III of the First Amended Complaint. Plaintiff Charles Moench shall serve as representative of the Class.

2. The Class certified herein shall be defined as follows: Any individual who was a participant or beneficiary of the Statewide Bancorp Employee Stock Ownership Plan

sponsored by Statewide Bancorp, Toms River, New Jersey from October 20, 1988 to the present. This will include a sub-class of contributing participants.

3. Plaintiff Charles Moench shall also be permitted to prosecute Counts IV and V of the First Amended Complaint filed in this Action derivatively pursuant to Rule 23.1 on behalf of the Statewide Bancorp Employee Stock Ownership Plan.

SO ORDERED this 17th day of December, 1993.

Honorable Mary Little Parell

United States District Court

Appendix E

Memorandum and Order of the District Court
on Cross-Motions for Summary Judgment
(September 20, 1994)

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

CHARLES MOENCH, in his own right and on behalf of all those similarly situated, and on behalf of the Statewide Bancorp Employee Stock Option Plan,	CIVIL ACTION NO: 92-4829 (MLP)
Plaintiff,	
v.	**MEMORANDUM AND ORDER**
JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., RAYMOND A. TAYLOR,	
Defendants.	

PARELL, District Judge

This matter comes before the Court on plaintiff's motion for partial summary judgment and on defendants' cross-motion for summary judgment. For the following reasons, plaintiff's motion is granted and defendants' motion is granted.

BACKGROUND

Plaintiff Charles Moench was an employee at Statewide Bancorp ("Statewide"), a bank holding company with its principal office in Toms River, New Jersey. As an employee of Statewide, plaintiff became a member of the Statewide Bancorp Employee Stock Ownership Plan (the "Plan" or the "ESOP").

The plan became effective on January 1, 1986 and employees of Statewide with at least one year of service were eligible to participate in the Plan. The Plan was funded by voluntary employee contributions made through payroll deductions and by Statewide's partial matching of those contributions.

The terms of the Plan provided that "[t]he primary investment of the Plan shall be Statewide Bancorp Common Stock." (Ex. A to Memo in Support of Pls.' Mot. for Partial Summary Judgment: Summary Plan Description of the Statewide Bancorp ESOP at 1.) The Plan further provided that "the Trustee[1] is authorized to invest and hold

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[1] Statewide appointed its banking subsidiary, The First National Bank of Toms River, N.J. (the "Bank"), as the Trustee for the Plan. (Summary Plan Description at 1.)

up to 100% of the Trust Assets in Employer Securities. As such, Statewide Bancorp Common Stock (Employer Securities) shall be purchased within 30 days after the end of the month in which funds are received from the Employer." (Id.) Still further, the Plan provides that it "is a capital accumulation Plan [and therefore] . . . does not provide for a guaranteed benefit at retirement." (Id.)

Sometime in 1989, Statewide began experiencing financial difficulties. Between July 1989 and December 1989, the market value of Statewide Bancorp common stock fell from $18.25 per share to $9.50 per share. (Ex. B to Pls.' Mem. in Opposition to Defs.' Cross-Motion for Summary Judgment: Stock Price List Produced by Defendants.) By July 1990, the market value of the stock had fallen to $6.00 per share and, by December 1990, it had fallen to $2.25 per share. (Id.) In May 1991, the market value of the stock was less than 25 cents per share. (Id.)

During this time period of approximately two years, defendants were directors of The First National Bank of Toms River, N.J. and were also members of the committee responsible for administering the Plan. As set forth in the Plan Prospectus dated July 7, 1986, and as asserted by plaintiffs and recognized by defendants, the plan committee was "authorized to: execute documents on behalf of [Statewide]; determine all questions relating to the administration and application of the Plan; establish and maintain individual accounts for each participant; maintain all data, records, documents and papers pertaining to the administration of the Plan; direct investments to be made by the Trust; and make any other determinations necessary or advisable for administration of the Plan. (Ex. G to Certif.

of Christopher J. Carey: Plan Prospectus dated July 7, 1986 at 6; Amended Complaint ¶ 24; Defs.' Br. in Support of Cross-Motion for Summary Judgment at 2.) From the period October 20, 1988 through April 16, 1991,[2] defendants directed purchases of Statewide Bancorp Common Stock for the Plan.

Apparently at some point in late 1989 or early 1990, federal authorities became concerned with the rapid deterioration of the bank's financial condition. Pursuant to subsequent investigation, the federal authorities became specifically concerned with the manner in which the bank was being supervised and managed. By receipt of copies of reports prepared by the Office of the Comptroller Corporation and the Federal Deposit Insurance Corporation ("FDIC"), defendants were notified of these concerns. On May 22, 1991, the FDIC seized control of the bank. On May 23, 1991, Statewide filed a petition under Chapter 11 of the Bankruptcy Code.

Plaintiff filed the Complaint in this action on November 11, 1992. Counts One through Three of the Complaint were styled as a class action and Count Four was brought as a stockholder's derivative suit. The Complaint alleged that defendants breached their fiduciary duties to the Plan and its participants in violation of §§ 1104, 1106, and 1109 of the Retirement Income Security Act ("ERISA"), 20 U.S.C. § 1001, et seq., by (1) failing to terminate or amend the Plan

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[2] This litigation has been certified as a class action wherein the class is defined as those individuals who were participants or beneficiaries of the Plan during the time period commencing on October 20, 1988 to present.

in a timely fashion in order to obtain maximum current value for the Plan's securities (Count One), and (2) by failing to disclose complete and accurate information to Plan participants regarding the security of the funds invested in the Plan (Count Three). Count Two of the Complaint sought to hold defendants liable for the alleged wrongful conduct of their co-directors. Plaintiff moved to certify the litigation as a class action. Defendants moved to dismiss plaintiff's complaint.

By Memorandum and Order dated August 17, 1993, this Court granted defendants' motion to dismiss Count One of the Complaint on the basis that ERISA's fiduciary duties do not extend to decisions to amend or terminate a plan. Defendants moved to dismiss Counts Two and Three of the Complaint on the basis that these claims could only be asserted in a stockholders' derivative action. The Court denied defendants' motion to dismiss Counts Two and Three holding that plaintiff's claims were not exclusive to a stockholder derivative action and if defendants were found to have breached a fiduciary duty to Plan participants as alleged by plaintiff in Counts Two and Three, defendants may be held liable under ERISA for any such breach. The Court granted defendants' motion to dismiss Count Four for deficiencies in pleading a stockholder's derivative action. However, the dismissal of Count Four was without prejudice to plaintiff's right to correct the noted deficiencies by amending the Complaint and to move to reinstate such an action. Plaintiff's motion to certify a class action was adjourned for further briefing.

On September 20, 1993, plaintiff filed an Amended Complaint. Plaintiff asserts the following causes of action

against defendants in the Amended Complaint: (1) class action[3] for alleged breach of various fiduciary duties owed to the Plan and its participants in violation of ERISA (Counts One, Two and Three); stockholder's derivative action, on behalf of the Plan as a stockholder of Statewide, for breach of the various ERISA fiduciary duties allegedly owed to the Plan and its participants and for securities violations (Counts Four and Five).[4]

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[3] See supra note 2.

[4] Specifically, plaintiff alleges in Counts One through Four that each of the individual defendants breached their fiduciary duties under ERISA by engaging in the following actions and inactions:

- failing to administer the Plan in the best interests of the participants and acting in their own personal interests and the interests of the bank rather than in the interests of the Plan participants;

- failing to take any action to protect the Plan's assets from dissipation;

- failing to advise the Plan participants or the bank as Trustee that continued investment in the bank stock was speculative and inappropriate for a retirement plan in light of the bank's financial condition;

- failing to advise the Plan participants that they should stop contributing to the Plan and continuing to accept and invest the participants' money when it was unreasonable to do so;

(continued...)

By Order dated December 20, 1993, defendants having indicated they did not oppose class certification, the Court

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[4](...continued)

- failing to diversify the investments or request an amendment to the Plan to permit diversified investments;

- failing to resign and continuing in the dual roles as both director and Plan fiduciary when it was clear that the dual roles presented a conflict of interest;

- administering a Plan that was in derogation of the standards and duties imposed by ERISA;

- failing to learn of or investigate the status of the bank's financial condition in order to adequately discharge the duties as a fiduciary of the Plan;

- failing to take legal action on behalf of the Plan in connection with the decline in the value of the bank stock;

- failing to make complete and accurate disclosures to the Plan participants as required by ERISA as to the following material facts;

  - the nature and quality of investment in the Plan;

  - the security of the investment in the Plan;

  - the true financial condition of the Plan.

(Am. Compl. at 18-25.)

certified this litigation to proceed as a class action pursuant to F.R.Civ. P. 23(b)(1)(B) and 23.2, with respect to plaintiff's claims under Counts One, Two and Three of the Amended Complaint and ordered that plaintiff would be permitted to prosecute Counts Four and Five of the Amended Complaint as a derivative action on behalf of the Plan.

DISCUSSION

Plaintiff, in moving for partial summary judgment, argues that defendants are fiduciaries of the Plan and seeks judgment as a matter of law on this issue. Defendants respond to plaintiff's motion by stating that they "do not dispute that they were fiduciaries of the ESOP." Thus, plaintiff's motion for partial summary judgment on this issue shall be granted.

However, while defendants concede that they are fiduciaries of the Plan, they cross-move for summary judgment on Counts I-IV of the Amended Complaint on the basis that they did not breach any of their fiduciary duties under ERISA and Count V on the basis that plaintiff fails to set forth a viable cause of action for securities violations.

A court shall enter summary judgment under Federal Rule of Civil Procedure 56(c) when the moving party demonstrates that there is no genuine issue of material fact and the evidence establishes the moving party's entitlement to judgment as a matter of law. Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986). In order to defeat a motion for summary judgment, the opposing party must establish that a genuine issue of material fact exists. Jersey Cent. Power & Light Co. v. Lacey Township, 772 F.2d 1103, 1109 (3rd

Cir. 1985), cert. denied, 475 U.S. 1013 (1986). A nonmoving party may not rely on mere allegations; it must present actual evidence that creates a genuine issue of material fact. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986) (citing First Nat'l Bank of Arizona v. Cities Service Co., 391 U.S. 253, 290 (1968)); Schoch v. First Fidelity Bancorporation, 912 F.2d 654, 657 (3d Cir. 1990). Issues of fact are genuine only "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Anderson v. Liberty Lobby, Inc., 477 U.S. at 248.

I. Claims for Breach of Fiduciary Duty

As previously recognized by this court in its Memorandum and Order dated August 17, 1993, a decision to terminate or amend an ESOP or other ERISA plan is not a decision subject to fiduciary standards.[5] For this reason, the Court held that defendants did not have a fiduciary duty to terminate or amend the Plan. (Memorandum and Order dated August 17, 1993 at 4.)

Plaintiff argues that, while it may be true that defendants did not have the authority under the terms of the Plan to terminate or amend the Plan, they had the inherent authority as administrators of the Plan to take various other actions and that they breached their fiduciary duties by failing to take any such action. See supra note 4.

"Congress expressly intended that the ESOP would be both

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[5] A decision either to terminate or amend a plan is generally a decision left exclusively to the sponsor of the plan who is usually the employer. Here, the sponsor of the Plan was Statewide Bancorp.

an employee retirement benefit plan and a technique of corporate finance that would encourage employee ownership." Martin v. Feilen, 965 F.2d 660, 664 (8th Cir. 1992), cert. denied, ___ U.S. ___, 113 S. Ct. 979 (1993). Thus, "[b]ecause an ESOP invests primarily in employer stock, the value and security of the employees' retirement fund necessarily fluctuates with the fortunes of the employer. This is in contrast with the more common pension benefit plan, for which Congress created the Pension Benefit Guaranty Corporation ("PBGC") to provide a guarantee of retirement income if the sponsoring employer should become insolvent." Roth v. Sawyer-Cleator Lumber Co. Employee Stock Ownership Plan, 805 F. Supp. 1475, 1479 (D. Minn. 1992), rev'd on other grounds, 16 F.3d 915 (8th Cir. 1994).

The general fiduciary responsibility provisions of 29 U.S.C. § 1104 provide, among other things, that a fiduciary must discharge his or her duties respecting the plan solely in the interests of the plan participants and beneficiaries and in a prudent manner. Martin v. Feilen, 965 F.2d 660, 665 (8th Cir. 1992), cert. denied, ___ U.S. ___, 113 S. Ct. 979 (1993). However, as recognized by the Court of Appeals for the Eighth Circuit in Martin v. Feilen, an employer's business decisions will often indirectly affect an ESOP plan and its participants:

> Virtually all of an employer's significant business decisions affect the value of its stock, and therefore the benefits that ESOP plan participants will ultimately receive. However, ERISA's fiduciary duties under § 1104 attach only to transactions that involve investing the ESOP's assets or administering the plan. Accord, Canale v. Yegen,

> 782 F. Supp. 963, 967 (D.N.J. 1992). A broader rule would make ESOP fiduciaries virtual guarantors of the financial success of the plan . . . We cannot reconcile such broad liability with the congressional intend to encourage the use of ESOPs as a technique of corporate finance.

Id. at 666.

A person who is an ERISA fiduciary is not liable under § 1104 of ERISA by virtue of the fact that the person is also a director or officer who is responsible for making corporate decisions.[6] Id. Such a person cannot be held liable under § 1104 where the action challenged by the plaintiff is related to the day-to-day business decisions made by the person in his or her capacity as a corporate director or officer. In order to hold such a person liable, the challenged conduct must relate directly to action taken by the person in his or her capacity as an administrator of the plan. Id.

Fiduciaries of an ESOP are "understood to have such powers as are necessary or appropriate for carrying out the purposes of the trust." Ershick v. United Missouri Bank of Kansas City, N.A., 948 F.2d 660, 666 (10th Cir. 1991).

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[6] Plaintiff alleges that a conflict of interest existed in defendants' having acted as both directors of the bank and as fiduciaries of the Plan. However, plaintiff has not produced any evidence which support this general allegations. The fact that a defendant has acted as both a director and an ESOP fiduciary without more does not present a justiciable claim for conflict of interest. See Martin v. Feilen, 965 F.2d at 670.

"In exercising their powers, however, ERISA fiduciaries are required to interpret their plans 'in accordance with the documents governing the plan insofar as such documents and instructions are consistent with ERISA § 1104(a)(1).'" Id. (quoting Pratt v. Petroleum Production Management Employee Savings Plan, 920 F.2d 651, 657 (10th Cir. 1990)). An ERISA fiduciary may be liable for a failure to act only to the extent that the ERISA plan provides the fiduciary with the discretion to act. See Martin v. Feilen, 965 F.2d at 669; Associates In Adolescent Psychiatry, S.C. v. Home Life Ins. Co., 941 F.2d 561, 569 (7th Cir. 1991), cert. denied, ___ U.S. ___, 112 S. Ct. 1182 (1992) (citing Leigh v. Engle, 727 F.2d 113, 133-35 (7th Cir. 1984)). Judicial review of the decisions of fiduciaries in the exercise of their powers is highly deferential and will be upheld unless the decisions are shown to be arbitrary and capricious, not supported by substantial evidence, or erroneous on a question of law. Ershick v. United Missouri Bank of Kansas City, N.A. at 667.

Here, the terms of the Plan required defendants to invest the Plan funds in Statewide Bancorp Common Stock within 30 days after the end of the month in which the funds were received. It is clear by the terms of the Plan that it did not afford defendants any discretion in directing the investment of the Plan funds in any other manner.

Plaintiff has failed to establish that the Plan itself was a violation of ERISA or that it was inconsistent with §§ 1104(a)(1) of ERISA. Although plaintiff has established that defendants directed purchases of Statewide Bancorp Common Stock for the Plan up until April of 1991 and that the value of this stock continually declined from

approximately July 1989 to May 1991, plaintiff has failed to establish that defendants' actions in directing the purchases of stock for the Plan were other than in accordance with the requirements of the Plan or otherwise in violation of ERISA.

As for plaintiff's allegations that defendants failed to make complete and accurate disclosures to the Plan participants regarding the security of investment in the Plan and regarding the true financial condition of the Plan, the facts simply do not support these allegations. The Plan specifically provides that it "is a capital accumulation Plan [and therefore] . . . does not provide for a guaranteed benefit at retirement." Moreover, the very nature of ESOP plans contemplates that the value and security of the employees' retirement fund will necessarily fluctuate with the fortunes of the employer because ESOPs invest primarily in employer stock. Plaintiff has not presented any evidence that defendants made any misrepresentations regarding the financial condition of the Plan or that defendants failed to make any disclosure required under ERISA.

Plaintiff urges that the decision of the court in Canale v. Yegan, 782 F. Supp. 963 (D.N.J. 1992) ("Canale I"), as amended, 789 F. Supp. 147 (D.N.J. 1992) ("Canale II"), should control the outcome here. In Canale I, the court held that it is possible to state a claim for breach of fiduciary duty under ERISA based on allegations that an ESOP plan administrator failed to prudently diversify plan assets. Canale I at 968. In Canale II, the court clarified its prior decision by stating that the plaintiff had stated a claim for breach of duties of care and prudent diversification imposed by ERISA insofar as the plaintiff had specifically alleged fraudulent, self-dealing conduct on the part of defendants.

Plaintiff has not presented any evidence that defendants here engaged in any fraudulent, self-dealing conduct in administering the Plan. Therefore, the alleged facts which were relevant to deciding whether to grant the defendants' motion to dismiss in Canale are significantly different from the facts presented in this case in the context of defendants' motion for summary judgment. Thus, the Canale decisions are not dispositive of the issues herein.

Plaintiff has not presented evidence which creates a genuine issue of material fact as to his claims for breach of fiduciary duty. Thus, defendants are entitled to summary judgment in their favor on plaintiff's claims for breach of fiduciary duty and, accordingly, defendants' cross-motion for summary judgment on Counts I-IV shall be granted.

II. Claims for Securities Violations

Defendants argue for summary judgment on Count V of the Amended Complaint on the basis that plaintiff fails to set forth a viable cause of action for securities violations.

Defendants first argue that the cause of action for securities violations fails as a matter of law because plaintiff has not alleged the requisite "purchase or sale" of "securities." In support of this argument, defendants cite Childers v. Northwest Airlines, Inc., 688 F.Supp. 1357, 1362 (D. Minn. 1988). However, the facts in Childers differ significantly from those presented here. In Childers, the court rejected the plaintiffs' argument that the ESOPs themselves constituted investment contracts which were "securities" and that plaintiffs' participation in the ESOPs was a "purchase" of a security within the meaning of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).

Here, it is the purchase of the bank stock which plaintiff alleges was in violation of § 10(b). Thus, plaintiff has sufficiently alleged the "purchase" of a "security" within the meaning of § 10(b).

However, defendants also argue that plaintiff's securities action is barred by the statute of limitations. The statute of limitations for plaintiff's cause of action set forth in Count V is one year from the date upon which plaintiff discovered that defendants had made allegedly misleading statements in connection with the purchase of a security. Based upon the facts before this Court, it appears that plaintiff should have reasonably discovered any such misrepresentations no later than May 22, 1991, when the FDIC seized control of the bank, or on May 23, 1991, when Statewide filed a petition under Chapter 11 of the Bankruptcy Code.

Plaintiff first asserted a cause of action for securities violations in the Amended Complaint which was filed on September 20, 1993. Thus, more than one year had elapsed from the date of discovery prior to plaintiff having filed the securities action.

The burden is on plaintiff here to establish circumstances which tolled the statute of limitations. Auslender v. Energy Management Corp., 832 F.2d 354, 356 (6th Cir. 1987). Plaintiff argues that the statute of limitations on this action was tolled by Lerner v. Statewide Bancorp, Civ. No. 90-1552 (MLP).

Lerner was a class action brought on behalf of "all persons who purchased the publicly traded securities of Statewide Bancorp during the period beginning October 20, 1988 through and including May 25, 1990." (Stipulation and

Order Regarding Class Certification filed in the Lerner action on September 14, 1990 ¶ 1.) The Lerner action was filed on June 12, 1990 and was subsequently settled on June 4, 1993. Although it is apparent there was some debate as to whether or not the ESOP was a member of the class in Lerner, the Stipulation and Order which defined the class in Lerner specifically excluded any "trusts or entities" controlled by the present or former officers and directors or affiliates of Statewide. (Id.) Thus, since the ESOP was a trust and since trusts were specifically excluded from the Lerner class, it is clear that the ESOP was never a member of the Lerner class. This fact was confirmed by Magistrate Judge John J. Hughes at the hearing on approval of the proposed settlement in Lerner, which was held on June 4, 1993, wherein he ruled that the ESOP was not a member of the Lerner class as that class had been defined in the Stipulation and order filed on September 14, 1990. (See Tr. of Hr'g on Approval of the Proposed Settlement in Lerner at 27.)

Thus, since this Court concludes that the ESOP was never a member of the class in Lerner, plaintiff's claims for securities violations asserted herein were not tolled by the Lerner action. Accordingly, plaintiff's claims for securities violations asserted in Court V are barred by the statute of limitations.

IT IS therefore on this 20th day of September, 1994, **ORDERED** that plaintiff's motion for partial summary judgment is hereby **GRANTED**; and

IT IS FURTHER ORDERED that defendants' cross-motion for summary judgment is hereby **GRANTED**.

MARY LITTLE PARELL

United States District Judge

Appendix F

Order of the Court of Appeals for the Third Circuit
on Petition for Rehearing
(September 12, 1995)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 94-5637

CHARLES MOENCH
in his own right and on behalf of those similarly situated,
and on behalf of the
Statewide Bancorp Employee Stock Option Plan

v.

JOSEPH W. ROBERTSON, RICHARD D. SUTTON, JOSEPH P. IARIA, FRANK J. EWART, JACK MEYERS, LEONARD G. LOMELL, JOHN C. FELLOWS, JR., RAYMOND A.
TAYLOR, ESTATE OF FRANK EWART, JOHN EWART,
ADMINISTRATOR

Charles Moench, in his own right and on behalf of all those similarly situated, Appellant.

On Appeal from the United States District Court
for the District of New Jersey.
(D.C. No. 92-4829).

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, Chief Judge, and BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS, MCKEE, and SAROKIN, Circuit Judges

The petition for rehearing filed by the appellees, Joseph W. Robertson, Richard K. Sutton, Joseph P. Iaria, Jack Meyers, Leonard G. Lomell, John C. Fellows, Jr., Dr. Raymond A. Taylor, and John Ewart, as Administrator for the Estate of Frank J. Ewart, in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the court in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

BY THE COURT,

Morton I. Greenberg
Circuit Judge

DATED: September 12, 1995